Petition

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No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1981

MOUNT VERNON MEMORIAL PARK and FOY E. BRYANT,
Petitioners,

VS.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

ROBERT PATRICK MURPHY
COUNSEL OF RECORD
O'BRIEN AND HALLISEY
A Professional Corporation
One California Street,
Suite 2535
San Francisco, CA 94111
Telephone: (415) 433-5300
On behalf of the Petitioners named above.

BOWNE-PERNAU WALSH • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

QUESTION PRESENTED

Is it the intent of Congress to regulate as an investment company of the "face-amount certificate" class under the Investment Company Act of 1940 a non-liquid assets business, which has never been in or held itself out as being in the business of investing, solely as a result of its having outstanding as an indivisible part of its business contracts any form of certificate which includes an alternative obligation to pay a stated sum at a date more than 24 months after its issuance and for which the payment was made in periodic installments of stated or determinable sums?

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SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners, Mount Vernon Memorial Park and Foy E. Bryant respectfully pray that a Writ of Certiorari be issued to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on January 4, 1982.

OPINION BELOW

The opinion of the Court of Appeals had not been reported in the F.2d at this writing. It appears in the Appendix hereto, pp. B-1 to B-38. A statement of the findings, conclusions, and orders adopted by the District Court for the Eastern District of California appears in the Appendix, pp. D-1 to D-55. Its initial Statement of Intended Decision appears in the Appendix, pp. C-1 to C-14.

JURISDICTION

The judgment of the Court of Appeals for the Ninth Circuit was entered on January 4, 1982. A timely petition to that Court for rehearing was denied on February 8, 1982. The filing of this Petition for Certiorari is within 90 days of the latter date. The jurisdiction of this Court is invoked under Title 28 U.S. Code Section 1254(1).

STATUTORY PROVISIONS INVOLVED

The Investment Company Act of 1940, as amended (54 Stat. 789 to 847), and particularly Sections 3(a) and 3(b), 2(a)(15), 1(a)(2), 7(a), 28(a), (b), (d) and (i), 42(e), 47(b) as effective to October 21, 1980, and 49 (15 U.S. Code, Sections 80a-3(a) & 3(b), 80a-2(a)(15), 80a-1(a)(2), 80a-7(a), 80a-28(a), (b), (d) & (i), 80a-41(e), 80a-46(b), and 80a-48). The pertinent text of these sections appears in the Appendix hereto, pp. A-1 to A-16.

STATEMENT OF THE CASE

A. Relevant Background of Mt. Vernon's Involvement

Mount Vernon Memorial Park operates a substantial cemetery-mortuary just outside the city of Sacramento, California with physical facilities modeled after the George Washington home on the Potomac River. Prior to 1979 Foy E. Bryant was its president and principal shareholder. In 1979 he resigned as an officer and director and sold his controlling interest.

In addition to sales of its services and cemetery spaces for cash, in the mid-1960s Mount Vernon began to sell

cemetery plots and funeral services on an anticipatory or "pre-need" basis. Pre-need purchasers can make their own decisions about the nature and cost of their last rites by contracting to purchase cemetery spaces and funeral services in the future. Mount Vernon agreed to provide specified funeral and burial arrangements at a fixed price, regardless of the prevailing prices at the later time of death. The full payment could be made at the time of purchase or, more usually, in small monthly installments with any balance of the fixed price payable on death. Mount Vernon used a substantial percentage of the monies so received for its general operating expenses and the payments on its real property indebtedness.

Between 1970 and 1975 Mount Vernon offered a variation of the above arrangements, under which the agreement for a future burial at a presently fixed price was supplemented by a subscription agreement for "Pre-need Funeral Service Debentures" in a total amount equivalent to the agreed upon fixed price. Provisions allowing payment in small monthly installments were continued. The Debentures issued as part of the agreement are redeemable for the agreed upon burial services, or in the alternative for cash at maturity 20 years after the purchase date. In addition, they provide for payments of interest at low rates. This form of integrated agreement, consisting of the fixed-price commitment, a subscription, and the debenture instruments, was modeled on the same type of agreements being offered by a number of other cemetery-mortuaries. By their terms these offerings were limited to California residents,

and in practice to residents of the Sacramento area. Mount Vernon entered into approximately 4,900 such contracts.[1]

Printed offering circulars filed with and reviewed by the California Department of Corporations were required to be delivered to purchasers. For the first of the four $1 million dollar offerings the circulars gave notice that the net proceeds would be used to reduce Mount Vernon's debts and to supply working capital. For the remaining three offerings the circulars gave notice that the net proceeds would be used to retire Mount Vernon's real property debt and to pay for capital improvements. (See Appendix hereto, pp. C-9 and D-17.) Under the provisions of the offerings, 15% of the proceeds was set aside in a sinking fund, and the remaining 85% was being used in accordance with the business purposes referred to in the offering circulars.

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[1]Mount Vernon's subscription agreements and Debentures were registered by qualification with the California Department of Corporations under the State's Blue Sky law (Calif. Corporations Code Sections 25000-25705). Blue Sky law qualification (using the fair, just and equitable standard) established an exemption from California's Short Act (Calif. Business and Professions Code Sections 7735 *et seq.*) which provides that all payments on pre-need funeral services contracts must be available in trust for any pre-need purchaser at any time prior to the funeral and burial.

A 1969 Calif. Attorney General's interpretation of the Short Act had taken the position that a section of that statute providing that a cemetery authority need not establish a separate trust for pre-need funeral payments did not mean that depositing 60% under State cemetery regulations constituted compliance with the Short Act.

Although this state law situation was the occasion for Mount Vernon's decision to follow several other cemetery-mortuaries in the use of pre-need funeral service debentures, it is not relevant to the construction of the Federal Investment Company Act here.

B. S.E.C. Allegations In The District Court

In early 1977 the S.E.C. filed this civil action in the Eastern District of California, alleging Mount Vernon to be an unregistered investment company under Investment Company Act Sections 3(a)(2) and 2(a)(15). (Appendix, pp. A-1 to A-3 and pp. E-1 to E-13.)[2] Its complaint requested the District Court to declare that the Investment Company Act applies to Mount Vernon and its president, to issue injunctions, and to assume exclusive jurisdiction over Mount Vernon—in effect a receivership—as authorized by Investment Company Act Section 42(e). (Appendix, pp. A-15 to A-16 and E-14 to E-15.)

The S.E.C.'s Amended Complaint alleges (1) that Mount Vernon's Pre-need Funeral Service Debentures constitute "face-amount certificates of the installment type" within the definition in Section 2(a)(15) of the Act (Appendix, pp. A-3 and E-9); (2) that Mount Vernon "is currently engaged in the business of performing funeral and burial services and operating a cemetery" (Appendix, p. E-4); and (3) that, "as a result of" issuing such Debentures, Mount Vernon is an investment company under Section 3(a)(2) of the Act. (Appendix, pp. A-1 and E-12.) The Amended Complaint does not allege that Mount Vernon is or was "in the business" of issuing, offering or selling statutory face-amount certificates. (Appendix, pp. E-1 to E-15.) In oral argument before the District Judge, S.E.C. counsel clearly

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[2]The S.E.C. also alleged a second claim under the Securities Act of 1933 and the Securities Exchange Act of 1934. In March 1980, during pendency of the S.E.C. appeal, the second claim was settled and dismissed with prejudice by mutual consent of the parties without either admitting or denying the allegations of said claim.

stated plaintiff's position that having any such instruments outstanding will constitute the issuer an investment company, regardless of the actual nature of its business. The S.E.C. position in this case is the first recorded enforcement application of Section 3(a)(2) under this *rationale* in the first thirty-five years in which the Act had been in effect.[3]

C. Historical Background of the Move to Bring Cemetery-Mortuaries Using Pre-Need Debentures Under Investment Company Act Regulation

Investment companies "are basically institutions which provide a medium for public investment in pools of corporate securities." (Loss, *Securities Regulation,* Volume I, p. 144 and Supplement; cf. *U.S. v. Nat'l Ass'n of Securities Dealers,* 422 U.S. 694, 697-98, 95 S.Ct. 2427, 445 L.Ed. 2d 486 (1975).) In fact, the Investment Company Act recites Congressional findings that "the principal activities" of such companies are investing, re-investing, and trading in securities." (Sec. 1(a)(2). Appendix at p. A-3.) Such of the S.E.C. accounting regulations as are applicable to investment companies of the face-amount certificate company type only concern liquid and investment asset situations, not situations involving fixed or other operating assets. (17 C.F.R., §§ 210.6-20 through 210.6-24.) In discussing investment company regulation, Professor Loss pointed out, "The problems of the industry flow from the very nature of the assets of investment companies." (Loss, *Securities Regulation,* Volume I, p. 146 and Supplement.) The phenomenon of having detailed investment company regulation apply to a firm which must use non-liquid,

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[3]This point is discussed in more detail on pages 10 to 13, *infra.*

operating assets in its non-investment company business, as ruled by the Court of Appeals, suggests reference to the genesis of these hitherto unfamiliar face-amount provisions and their use during the first 35 years the Act was in effect.

Upon substantial completion of the S.E.C. Investment Trust Study, identical bills were introduced in the House and Senate on March 14, 1940. (S.B. 3580 and H.R. 8935.) During the month of April 1940, a Senate subcommittee held hearings on the proposed legislation. There was extensive participation by representatives of the industry and the specific companies which would be regulated. At the suggestion of the subcommittee, for several weeks following conclusion of the initial hearings these investment company representatives held meetings with the S.E.C. staff. The meetings resulted in a revised, compromise bill. (S.B. 4108 and H.R. 10065.)[4]

On March 13, 1940, the day before the initial legislative proposal had been introduced, the S.E.C. submitted the last supplement to the Investment Trust Study. This was a comparatively short report on a business activity then being engaged in by Investors Syndicate of Minneapolis (now Investors Diversified Services) and two other investment companies studied, known as the "face-amount certificate business." (76th Cong., 3d Sess., H.R. Doc. No. 659).

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[4]Pertinent citations are at Appendix pp. D-31 to D-37. In *Willheim v. Murcheson*, 342 F.2d 33, 42 (2nd Circuit, 1965), cert. denied, 382 U.S. 840, Judge Friendly pointed out that the Investment Company Act was the product of joint effort and compromise between the S.E.C. and the specific industry to be regulated, and that it was drafted with a good deal of specificity toward that end. The Court of Appeals opinion below makes only cursory reference to this fact. (See Appendix hereto p. B-30.)

The face-amount certificates described in that supplement were simply unsecured evidences of indebtedness for the saving of money to be returned with interest in future years, provided that the purchaser promptly and without delinquency made all of the required installment payments. The supplement took note that widespread sales of these certificates were made by the investment companies being studied to small savers on the basis of misleading comparisons to savings bank deposits and insurance policies. In many cases small savers would start such contracts, make some installment payments, and then have to quit because of economic circumstances of the times. This "lapse experience" would be particularly high during the first and second years when the certificate had no surrender value. Also, the small saver would not receive any interest on his entire deposit during any time he was in default on his installments, no matter how much he had paid in.

These investment companies were thus profiting unfairly at the expense of those who could ill afford it in those hard economic times. As the Court of Appeals admits, each of the companies making use of face-amount certificates, as described in that supplement, was engaged in the business of investing in securities of other issuers. (*cf.* Appendix, pp. B-33 and B-34.) That supplement entitled Companies Issuing Face-Amount Installment Certificates was an appendage to the entire Investment Trust Study. It did not consider any situation in which instruments of this type might be an integral part of contracts for some other purpose by some other type of business, such as the fixed-price funeral services agreements used by Mount Vernon. (*cf.* Appendix, pp. D-37 to D-42.)

During the May 1940 meetings between the S.E.C. staff and the group which included representatives of the then face-amount certificate businesses, modifications applicable to such companies were incorporated in the new bill. In addition to the detailed regulatory framework applicable to all investment companies, companies in the business of issuing face-amount certificates would be subject to special restrictions on the provisions which would have to be contained in such certificates and on the use of installment payment monies received in consideration for them. (Sec. 28. Appendix at pp. A-5 to A-15.)

The structure of the modified legislation made it almost impossible for any company not in the businesses of in-turn investing or holding cash and high grade securities to be in the face-amount certificate business. The legislation required over 90% of all monies received after the first year to be maintained in reserves in the form of cash or securities approved for life insurance companies under the District of Columbia Code. It required such reserves to be available as a "cash surrender value" for return to the purchaser with a rate of interest stated by the statute. (Sec. 28(b) and (d), Appendix pp. A-9 and A-10.) It additionally required that such a company have capital stock, which was paid for in cash, of not less than $250,000. (Sec. 28(a)(1), Appendix p. A-5.) The legislative history contains no indication that either the S.E.C. staff, the investment company representatives who negotiated with them, or the Congressional committee members had any idea that by reason of the added sections 3(a)(2) and 2(a)(15) the bill would apply to operating companies, such as this local cemetery-mortuary. (*See* Appendix p. D-37.)

By June 1940, after the face-amount certificate company provisions had been in effect for six months, eleven such companies had registered with the S.E.C. under those provisions. The largest of them by far (Investors Syndicate) then discontinued that line of its business. (*S.E.C., Seventh Annual Report,* p. 43.) The S.E.C. annual reports for the first thirty-five years in which the Investment Company Act was effective indicate that only one case was ever brought under Sec. 3(a)(2)—a 1943 action in the District Court in Oklahoma which obtained a consent injunction against the Guarantee Income Trust. (*See S.E.C., Ninth Annual Report,* p. 55.) By 1962 only ten out of the then 727 registered investment companies were also registered as face-amount certificate companies. (*S.E.C., Twenty-Eighth Annual Report,* p. 107).

The 1963 Report of the Special Study of Securities Markets of the S.E.C. started its chapter on open-end management investment companies by stating:

> Basically, all investment companies are companies in which a number of investors have pooled their resources to engage in the business of investing, of reinvesting and trading in securities of various issuers. Investment companies are classified by the Investment Company Act as either face-amount certificate companies, unit investment trusts, or management companies, the last being by far the most significant in terms of numbers and size. (88th Cong., 1st Sess., H. Doc. No. 95, Part Four, p. 96.)

By June 30, 1976, of the 1,286 registered investment companies only seven were face-amount certificate companies. *S.E.C., Forty-Second Annual Report,* p. 189.)

Prior to the end of 1975, a subsidiary of International Funeral Services, Inc., a stock exchange listed company which operated extensively in California, in 13 other states, and in three Canadian provinces, applied to the S.E.C. for an administrative dispensation from the Investment Company Act for certain long-term promissory notes which it called pre-need funeral service debentures. Those debentures were not an integral part of funeral arrangements for which a presently fixed price had been agreed upon. On January 5, 1976 the S.E.C. published an administrative opinion refusing to find that the applied-for exemption from the Act was in the public interest. (*In the Matter of Internat'l Funeral Services of Calif., Inc.,* Inv. Co. Act Release No. 9112 (Jan. 5, 1976); CCH Fed. Securities L. Rptr., 1975-1976 Decisions, ¶ 80,363.) As the opinion stated, International merely wished to sell long-term notes to subscribers who could later redeem them for funeral services at whatever price would then be charged by International. The purchasers would simply be loaning money to International at a very low interest rate. The opinion points out the purchasers would not be obtaining the benefits of a presently set price for future funeral services.

For purposes of the decision, whether International was in fact an investment company under Section 3(a)(2) of the Act was assumed and not specifically decided by the S.E.C. The opinion commented that the installment feature of International's proposal brought the Act into play and then reasoned that such unmarketable, long-term installment notes were the same type of instruments reported on in the 1940 Face-Amount Certificate supple-

ment to the Investment Trust Study. It further noted there was no guarantee that the debentures would cover the full cost of the funeral or that International would remain in business. [There was no indication whether International, like Mount Vernon, was a cemetery authority of the State of California. (Calif. Health & Safety Code §§ 7019 and 8275-8362.)] The opinion then stated that the tangential connection of International's "pre-need debentures" with funeral agreements which did not set a price was not an adequate basis for distinguishing those proposed debentures from face-amount certificates. Notably, the S.E.C. did not state that such fixed price contracts which had been issued up to 1973 rendered International an investment company of the face-amount certificate company type.

Following the January 1976 publication of the *International* opinion, the S.E.C. enforcement staff warned numerous cemetery-mortuaries which had used any type of pre-need funeral service debentures that, as a result of offering and issuing those installment debentures, they were unregistered investment companies under the Act. (Appendix, p. D-19.) It appears that this was the first time such a position had been taken. (Appendix, p. D-19.) Because Section 49 of the Act contains severe criminal penalties for wilful violation (Appendix, p. A-19.), Mount Vernon would have to act at its peril in continuing to receive installment payments on its thousands of outstanding commitments to perform funeral services at already agreed-upon fixed prices. The District Court subsequently found that as a result of S.E.C.'s warning Mount Vernon adopted the practice of setting aside in trust 100% of all

such installment funds received since early 1976 when the *International* decision became effective. (Appendix, pp. D-19 and D-20.) Segregation of such funds continues, pending final disposition of this litigation.[5]

D. The District Court Decision That the Investment Company Act Does Not Apply to Mount Vernon

At the December 12, 1977 pre-trial conference, nine months after this S.E.C. action was filed, the District Court issued a Statement of Intended Decision indicating it would grant defendant's Motion to Dismiss the Investment Company Act claim. (Appendix, pp. C-1 to C-14.) After the Court issued this Statement, the S.E.C. made no request to further amend its complaint.[6]

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[5]In March 1980 when the parties entered into a mutual consent to settle the second count of the SEC Complaint, Mount Vernon agreed to continue to keep segregated all installments received since early 1976 during the pendency of this appeal and to act with respect to those funds in a manner consistent with the final determination of this case. In March 1980 Mount Vernon further agreed to suspend voluntarily further receipts of such installments until the time of death and to continue following its voluntary practice of making full refunds when requested on an individual basis and whenever practicable to do so.

Before January 1976, it had used the installments in the manner described in the offering circulars, and those funds are not available without the liquidation of Mount Vernon's business.

[6]For over six months prior to its February 1977 commencement of the District Court action the S.E.C. staff had been taking testimony and subpoenaing voluminous documents under an S.E.C. formal order of investigation. In the nine months between the filing of the action and the District Judge's Statement of Intended Decision it conducted further discovery and other pre-trial proceedings. The complaint had previously been amended once after its initial filing.

When the S.E.C. subsequently requested detailed findings of fact and conclusions of law as to its Motion for Preliminary Injunction, the District Court adopted findings and conclusions in the format the S.E.C. requested, together with its orders dismissing the S.E.C.'s claim and denying its motion to take exclusive jurisdiction of Mount Vernon. (Appendix, pp. D-1 to D-55.)

The District Court ruled that merely by issuing this type of pre-need debenture Mount Vernon had not become engaged "in the business of issuing face-amount certificates of the installment type" as that language is used in Section 3(a)(2) of the Act. (Appendix, p. C-4.) The District Court found that Mount Vernon's debenture subscriptions were negotiated together with a pre-need funeral service contract which fixed the price for the future funeral services at the rate charged at the time of the formation of the contract and that, in addition to lending money to Mount Vernon, subscribers were also receiving the attendant benefit of fixing the price for future funeral services and guarding against inflation in the cost of such services. (Appendix, pp. C-8 to C-10.) The District Court concluded from its examination of the legislative history that Congress intended the extensive and onerous regulation provided by the Investment Company Act to be directed at traditional, liquid investment company operations where the "investment company" issues face-amount certificates of the installment type in order to create a liquid pool of capital which is in turn invested in other securities. (Appendix, pp. C-4 to C-5.)

The District Court found no indication that Congress even contemplated including under Section 3(a)(2) those companies or businesses which utilize face-amount certificates of the installment type to fund their own business operations, such as is the case with Mount Vernon. The District Court found this *rationale* to be particularly apparent where the effect of holding Mount Vernon to be an investment company under Section 3(a)(2) could effectively force it out of business, absent either an S.E.C. discretionary grant of exemption or a miraculous acquisition of sufficient liquid reserves to satisfy the requirements of the Act. The District Court found that this would ultimately pose a risk of loss to the certificate holders. (Appendix, pp. C-5 to C-7.)

After the S.E.C. requested formal findings, the District Court further found that Mount Vernon has not been, is not, and does not propose to be engaged "in the business of issuing face-amount certificates of the installment type" within the meaning of the Act, and that Mount Vernon has been and is operating a cemetery-mortuary and has not been held out to the debenture purchasers as being engaged in the business of investing. (Appendix, pp. D-22 to D-23.) In both its Statement of Intended Decision and its subsequent findings and conclusions the District Court accorded due respect to the principle that remedial legislation is to be broadly construed, but found no indication of a Congressional purpose to apply the broad strictures and regulations of the Investment Company Act to businesses outside the investment company field. (Appendix, pp. C-10 to C-11 and D-47.)

E. The Court of Appeals Decision to Uphold the SEC Position

The Court of Appeals held that Congress intended to regulate companies which have issued face-amount certificates as investment companies because of the type of certificates such companies issue or have issued, i.e., any certificate having installment features within Section 2(a)(15). The fact that such companies are not in the business of investing in other securities was held irrelevant. (Appendix, pp. B-35 to B-37.) The opinion states that the legislative history does not indicate that the existence of a liquid pool of re-investment capital is an "essential" characteristic of an investment company of the face-amount certificate company type. While the opinion refers in passing to the need to analyze the structure of the entire Act as well as its purpose (Appendix, p. B-35), the Court's only discussion of the consequences of applying detailed investment company regulation to fixed assets companies is a statement that it saw no particular regulations specified as "unfairly" applied here and that, while administrative burdens are imposed, few regulatory schemes are without them. (Appendix, p. B-37, footnote 9.)

The Court expressly acknowledges that the ultimate objective of the Act is to regulate "liquid pools of public savings entrusted to the 'investment' company management for investment in productive enterprise." (Appendix pp. B-31 to B-32.) And in discussing the 1940 Face-Amount Certificate supplement to the S.E.C. Investment Trust Study, the Court also expressly acknowledges that the companies considered in that supplement "are different from

Mount Vernon because they used revenue from certificate sales for re-investment." (Appendix, pp. B-33 to B-34.)

However, the Court states that congressional concern was with the "plight" of those purchasing face-amount certificates and that Section 3(a)(2) was designed to control proliferation of such certificates because of the "nature of the certificates themselves." (Appendix, p. B-36, footnote 8). The opinion makes a statement that Mount Vernon admitted its debentures "literally" fit the definition Section 2(a)(15), but does not discuss the express contention of Mount Vernon's counsel that because those debentures were an integral part of fixed-price funeral agreements, as found by the District Court, they were outside the meaning of the Act. (Appendix, p. B-18.)[7] Nevertheless, in partial

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[7]Mount Vernon has always contended that merely because characteristics of its pre-need debentures arrangements overlap with those of traditional face amount certificates does not convert its business to that of a face amount certificate class of investment company. (Appellees' Brief in the Court of Appeals, pp. 36 and 44 and Counter Statement of Issues on p. 4.) The Court of Appeals omits mention of the District Court's findings of fact that Mount Vernon's debentures were part of joint contractual arrangements which included pre-need contracts at presently set prices. (See Appendix, pp. C-8 to C-10 and D-12 to D-14; *cf.*, Rule 52(a), F. R. Civ. Pro., and *Lundgren v. Freeman*, 307 F.2d 104, 113-114 (9th Cir., 1962).) Mount Vernon has made no express admission that its instruments are "literally" face amount certificates within Section 2(a)(15) of the Act.

We respectfully note that for the Court of Appeals to say that Mount Vernon's Pre-Need Debentures are "literally" within Investment Company Act Section 2(a)(15) can only be a restatement of its holding that Section 2(a)(15) literally applies whenever there is a two year maturity feature and an installment feature, even if these features are coincidentally an indivisible part of contracts for some other, non-investment company purpose. Mount Vernon has, of course, admitted that its Debentures include those features.

response to this contention the Court later comments that the clause in Section 2(a)(15), "unless the context otherwise requires," is at best neutral and has meaning "only, when applied to particular facts in light of Congress' intentions." (Appendix, p. B-25.) Consequently, the Court incorrectly omits to include the point that Mount Vernon's debentures are not statutory face amount certificates in its statement of the issue to be decided. (*cf.* pp. 11 and 14, *supra.*)

Although an early part of its discussion alluded to the historical fact that the face-amount certificate company provisions were only added after meetings with representatives of specific companies to be regulated (Appendix, pp. B-30 to B-31), the Court fails to discuss this fact in its direct consideration of the legislative history. The Court held that the legislative history was not sufficient to overcome what it determined to be a "command" dictated by "absolute" statutory language. (Appendix, *cf.* p. B-29 with B-22.) In its discussion of the statutory language the Court eschews reference to Section 4 of the Act which implies that a face-amount certificate company is only one class of investment company. (Appendix, p. A-2. *cf.* material quoted on p. 10, *supra.*). It did not discuss the fact that the S.E.C. had declined to allege whether Mount Vernon was "in the business" of issuing face-amount certificates.

The Court of Appeals broadly construes the statutory definitions, decides in the first instance that Mount Vernon is in fact a Section 3(a)(2) investment company, and remands the case for further proceedings consistent with its opinion. (Appendix, pp. B-35 to B-37.)

REASONS FOR GRANTING THE WRIT

This case raises an important, well defined issue of federal law concerning the construction and administration of the Investment Company Act which has not been, but should be, settled by this Court. Forty-two years after the Act took effect, a Court of Appeals has held for the first time that investment company regulation applicable to face-amount certificate companies comprehends not simply the specific types of investment businesses which the Act's framers intended to discourage, but to any business having outstanding any certificates which include debt agreements maturing in more than two years and which have an installment feature. The appellate court has held that investment company regulation is appropriate without regard to the primary business in which a company is actually engaged and without regard to the type of assets which must be used in that business.

Under the Court of Appeals decision a company in Mount Vernon's position becomes (1) branded as an unregistered investment company, (2) is prohibited from doing any business in interstate commerce and from making specified uses of the mails (Section 7(a), Appendix, p. A-4 and A-5.), (3) is subject to S.E.C. action and future detailed regulation under the Act, (4) is subject to having its contracts become unenforceable,[8] and (5) is subject to lawsuits based on implied causes of action for violating the Act. Moreover, because it is subject to such lawsuits, it will be under a duty to report them as contingent liabili-

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[8]Section 47(b) was modified on Oct. 21, 1980 by P.L. 96-477, 94 Stat. 2277.

ties on its financial statements, which in turn can cause the drying up of credit it needs to run its business.

With respect to this particular case, Section 47(b) of the Investment Company Act, as effective to October 21, 1980, provided that "every contract" with regard to the rights of one in violation of any provision of the Act, who shall have made or performed said contract in violation of the Act, or continued any relationship or practice in violation of the Act, "shall be void." The decision of the Court of Appeals jeopardizes Mount Vernon's ability to perform approximately 4,900 debenture contracts for funerals and burials at prices giving the advantages of inflation to pre-need purchasers. (*cf.* Appendix, pp. C-5 to C-7.) These contracts are in jeopardy because the local cemetery-mortuary which made them has been found not to be in compliance with federal requirements applicable to mutual funds and other liquid asset investment operations, requirements which Mount Vernon's then counsel and the California Department of Corporations did not believe applicable. In addition to the direct effect of the Court of Appeals decision on Mount Vernon's thousands of customers[9], there is an important indirect effect on the customers of all similar cemetery-mortuaries, and on the customers of all other cemeteries and mortuaries *via* inflationary prices set at times of bereavement, which are in competition with the prices of these arrangements. Still further, the extent to which the Appellate Court's decision could have a domino effect on other lines of business is unforeseeable.

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[9]After 1975, when its Debenture offerings ceased, Mount Vernon entered into numerous pre-need contracts of which the debenture feature is not a part. Mount Vernon's ability to perform them is also jeopardized by the Court of Appeals decision.

The approaches to construction of the Investment Company Act employed by the Court of Appeals are open to serious question. The Court focused on distinct provisions of the Investment Company Act, as though they constituted a separate statute which then in turn incorporated all of the rest of the Investment Company Act regulations. This Court has held that interpretation of the Investment Company Act must involve a consideration of its purposes, as well as its structure. (*Burks v. Lasker*, 441 U.S. 471, 484-485, 99 S.Ct. 1831, 60 L.Ed.2d 404 (1979); *cf. U.S. v. Nat'l Ass'n. of Securities Dealers*, 422 U.S. 694, 703, 95 S.Ct. 2427, 45 L.Ed.2d 486 (1975).) The Court of Appeals held that the face-amount certificate provisions are a small, distinctive part of the Act. (Appendix, p. B-32, footnote 6.) Its opinion on this point does not discuss the consequences which follow from the decision: that all of the remaining regulatory sections of the Act apply to face-amount certificate companies as well as other types of investment companies. The Court manifestly did not examine the structure and purposes of the Act, as a whole. (*cf. NLRB v. Lion Oil Co.*, 352 U.S. 282, 288, 77 S.Ct. 330, 1 L.Ed.2d 331 (1957).)

The Court of Appeals not only omits consideration of the consequences of applying investment company regulation, as a whole, but also omits to consider the application of the specific regulations contained in Section 28 to a company which must use fixed and other operating assets in its business. (*cf.* Appendix p. B-37, footnote 9.) Had the Court of Appeals considered the specific application of Section 28 to non-investment asset businesses in contrast to liquid asset investment businesses, it would require further con-

sideration of the decision to use the mechanistic analysis which led it to conclude that if Section 3(a)(2) were not construed in this manner, that section would be superfluous in the Act. (Appendix pp. B-23 to B-25.) Since Section 3(a)(2) defines the classes of investment companies subject to Sections 28 and 29, it would not be superfluous if the District Court's construction applied.

This emphasis on the use of mechanical canons of construction, to the exclusion of a comprehensive consideration of the foreseeable consequences of broadly applying specific remedies which are only practical for specific types of businesses is contrary to the approaches to statutory construction approved by this Court in *Train v. Colorado Public Interest Research Group,* 426 U.S. 1, 9-10, 96 S.Ct. 1938, 48 L.Ed.2d 434 (1976). The Court of Appeals completely omits to consider in its later references to legislative history the fact of record that the face-amount certificate company provisions were added to the Act only after weeks of meetings with representatives of the specific investment companies to be regulated. The very specific regulation of those specific classes of investment company were clearly not on a level with the broad provisions of the type represented by the Securities Act of 1933 and the Securities Exchange Act of 1934, enacted after public outcry about scandalous conditions in the securities markets. Nevertheless, the Court of Appeals elevates the face-amount certificate company provisions to that level and in this case, makes them a factor in over 4,900 individual arrangements for last rites and burials.

Moreover, the Court of Appeals reaches for a literal application of the key definitional section of face-amount

certificates, contrary to the established rule that in construing definitions of terms such as "security", which make or do not make the regulatory statute applicable to a given case, "form should be disregarded for substance and the emphasis should be on economic reality." *United Housing Foundation, Inc. v. Forman,* 421 U.S. 837, 848, 95 S.Ct. 2051, 44 L.Ed.2d 261 (1975). In *Forman* this Court employed the established rule to decide that the use of certificates called "stock" did not make the federal securities laws applicable to a cooperative housing project, even though the certificates there were literally within the statutory definition which stated "any . . . stock". In *Forman* this Court considered the relevant economic criteria. In this case, the District Court considered relevant economic criteria, but the Court of Appeals did not. And a decision that the courts need not do so will cause substantial restrictions specifically designed for liquid-asset investment companies to apply to the conduct of non-investment businesses, a harmful result clearly not within the purposes of the Act.

CONCLUSION

For these foregoing reasons a writ of certiorari should issue to review the judgment and opinion of the Ninth Circuit.

Respectfully submitted,

ROBERT PATRICK MURPHY
O'BRIEN & HALLISEY
A Professional Corporation
One California Street
Suite 2535
San Francisco, CA 94111
Counsel for Petitioners

March 1, 1981

(Appendices follow)

Appendix

APPENDIX A

STATUTORY PROVISIONS INVOLVED

PERTINENT SECTIONS OF THE
INVESTMENT COMPANY ACT OF 1940,
AS AMENDED, 54 Stat.789-847

Sec.3(a) When used in this title, "investment company" means any issuer which -

(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any certificate outstanding; or

(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

As used in this section "investment securities" includes all securities except (A) Government securities (B) securities issued by employees' securities companies, and (C) securities issued by majority-owned subsidiaries of the owner which are not investment companies.

(b) Notwithstanding paragraph (3) of subsection (a), none of the following persons is an investment company within the meaning of this title:

(1) Any issuer primarily engaged, directly or through a wholly-owned subsidiary or subsidiaries, in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities.

(2) ... .

Sec. 4. For the purposes of this title, investment companies are divided into three principal classes, defined as follows:

(1) "Face-amount certificate company" means an investment company which is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or which has been engaged in such business and has any such certificate outstanding.

... .

Sec.2(a) When used in this title, unless the context otherwise requires-

...

(15) "Face-amount certificate" means any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments of a stated or determinable amount (which security shall be known as a face-amount certificate of the "installment type"); or any security which represents a similar obligation on the part of a face-amount certificate company, the consideration for which is the payment of a single lump sum (which security shall be known as a "fully paid" face-amount certificate).

Sec. 1(a) Upon the basis of facts disclosed by the record and reports of the Securities and Exchange Commission made pursuant to Section 30 of the Public Utility Holding Company Act of 1935, and facts otherwise disclosed and ascertained, it is hereby found that investment companies are affected with a national public interest in that, among other things -

(1) ... ;

(2) The principal activities of such companies-investing, reinvesting, and trading in securities-are conducted by use of the mails and means and instrumentalities of interstate commerce, including the facilities of national securities exchanges, and constitute a substantial part of all transactions effected in the securities markets of the Nation; ... .

Sec. 7(a) No investment company organized or otherwise created under the laws of the United States or of a State and having a board of directors, unless registered under section 8, shall directly or indirectly -

(1) Offer for sale, sell or deliver after sale, by the use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce;

(2) purchase, redeem, retire, or otherwise acquire or attempt to acquire, by use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person;

(3) control any investment company which does any of the acts enumerated in paragraphs (1) and (2);

(4) engage in any business in interstate commerce; or

(5) control any company which is engaged in any business in interstate commerce.

The provisions of this subsection (a) shall not apply to transactions of an investment company which are merely incidental to its dissolution.

Sec.28 (a) It shall be unlawful for any registered face-amount certificate company to issue or sell any face-amount certificate, or to collect or accept any payment on any such certificate issued by such company on or after the effective date of this title, unless-

(1) such company ... if organized on or after March 15, 1940, has capital stock in an amount not less than $250,000 which has been bona fide subscribed and paid for in cash; and

(2) such company maintains at all times minimum certificate reserves on all its outstanding face-amount certificates in an aggregate amount calculated and adjusted as follows:

(A) the reserves for each certificate of the installment type shall be based on assumed annual, semi-annual, quarterly, or monthly reserve payments according to the manner in which gross payments for

any certificate year are made by the holder, which reserve payments shall be sufficient in amount, as and when accumulated at a rate not to exceed 3-1/2 per centum per annum compounded annually, to provide the minimum maturity or face amount of the certificate when due. Such reserve payments may be graduated according to certificate years so that the reserve payment or payments for the first certificate year shall amount to at least 50 per centum of the required gross annual payment for such year and the reserve payment or payments for each of the second to fifth certificate years inclusive shall amount to at least 93 per centum of each such year's required gross annual payment and for the sixth and each subsequent certificate year the reserve payment or payments shall amount to at least 96 per centum of each such year's required gross annual payment: Provided: That such aggregate reserve payments shall amount to at least 93 per centum of the aggregate gross annual payments required to be made by the holder to obtain the maturity of the certificate. ... ;

(B) if the foregoing minimum percentages of the gross annual payments required under the provisions of such certificate should produce reserve payments larger than are necessary at 3-1/2 per centum per annum compounded annually to provide the minimum maturity or face amount of the certificate when due, the reserve shall be based upon reserve payments accumulated as provided under preceding subparageaph (A) of this subsection except that in lieu of the

3-1/2 per centum rate specified therein, such rate shall be lowered to the minimum rate, expressed in multiples of one-eighth of 1 per centum, which will accumulate such reserve payments to the maturity value when due;

(C) if the actual annual gross payment to be made by the certificate holder on any certificate issued prior to or after the effective date of this Act is less than the amount of any assumed reserve payment or payments for a certificate year, such company shall maintain as a part of such minimum certificate reserves a deficiency reserve equal to the total present value of future deficiencies in the gross payments, calculated at a rate not to exceed 3-1/2 per centum per annum compounded annually;

(D) for each certificate of the installment type, the amount of the reserve shall at any time be at least equal to (1) the then amount of the reserve payments set up under section 28 (a)(2)(A) or (B); (2) the accumulations on such reserve payments as computed under subparagraphs (A) or (B) of this paragraph (2);(3) the amount of any deficiency reserve required under subparagraph(C) hereof; and (4) such amount as shall have been credited to the account of each certificate holder in the form of any credit, or any dividend, or any interest in addition to the minimum maturity amount specified in such certificate, plus any accumulations on any amount or amounts so credited, at a rate not exceeding 3-1/2 per centum per annum compounded annually;

(E) for each certificate which is fully paid, including any fully paid obligations resulting from or effected upon the maturity of the previously issued certificate, and for each paid-up certificate issued as provided in sub-section (f) of this section prior to maturity, the amount of the reserve shall at any time be at least equal to (1) such amount as and when accumulated at a rate not to exceed 3-1/2 per centum compounded annually, will provide the amount or amounts payable when due and (2) such amount as shall have been credited to the account of each such certificate holder in the form of any credit, or any dividend, or any interest in addition to the minimum maturity amount specified in the certificate, plus any accumulations on any amount or amounts so credited, at a rate not exceeding 3-1/2 per centum per annum compounded annually;

(F) For each certificate of the installment type under which gross payments have been made by or credited to the holder thereof covering a payment period or periods or any part thereof beyond the then current payment period as defined by the terms of such certificate, and for which period or periods no reserve has been set up under sub-paragraph (A) or (B) hereof, an advance payment reserve shall be set up and maintained in the amount of the present value of any such unapplied advance gross payments, computed at a rate not to exceed 3-1/2 per centum per annum compounded annually;

(G) such appropriate contingency reserves for death and disability benefits and for reinstatement rights on any such certificate providing for such benefits or rights as the Commission shall prescribe by rule, regulations, or order based upon the experience of face-amount companies in relation to such contingencies.

At no time shall the aggregate certificate reserves herein required by subparagraphs (A) to (F), inclusive, be less than the aggregate surrender values and other amounts to which all certificate holders may be then entitled.

For the purpose of this subsection (a), no certificate of the installment type shall be deemed to be outstanding if before a surrender value has been attained the holder thereof has been in continuous default in making his payments thereon for a period of one year.

(b) It shall be unlawful for any registered face-amount certificate company to issue or sell any face-amount certificate, or to collect or accept any payment on any such certificate issued by such company on or after the effective date of this title unless such company has, in cash or qualified investments, assets having a value not less than the aggregate amount of the capital stock requirement and certificate reserves as computed under the provisions of subsection (a) hereof. As used in this subsection, "qualified investments"

means investments of a kind which life-insurance companies are permitted to invest in or hold under the provisions of the Code of the District of Columbia as heretofore or hereafter amended, and such other investments as the Commission shall by rule, regulation, or order authorize as qualified investments. Such investments shall be valued in accordance with the provisions of said Code where such provisions are applicable. Investments to which such provisions do not apply shall be valued in accordance with such rules, regulations, or orders as the Commission shall prescribe for the protection of investors.

(c) ... .

(d) It shall be unlawful for any registered face-amount certificate company to issue or sell any face-amount certificate, or to collect or accept any payment on any such certificate issued by such company on or after the effective date of this title, unless such certificate contains a provision or provisions to the effect -

(1) that, in respect of any certificate of the installment type, during the first certificate year the holder of the certificate, upon surrender thereof, shall be entitled to a value payable in cash not less than the reserve payments as specified in subparagraph (A) or (B) of paragraph (2) of subsection (a) and at the end of such certificate year, a value payable in cash at least equal to 50 per centum of the amount of the gross

annual payment required thereby for such year;

(2) that, in respect of any certificate of the installment type, at any time after the expiration of the first certificate year and prior to maturity, the holder of the certificate, upon surrender thereof, shall be entitled to a value payable in cash not less than the then amount of the reserve for such certificate required by numbered items (1) and (2) of subparagraph (D) of paragraph (2) subsection (a) hereof, less a surrender charge that shall not exceed 2 per centum of the face or maturity amount of the certificate, or 15 per centum of the amount of such reserve, whichever is the lesser, but in no event shall such value be less than 50 per centum of the amount of such reserve. The amount of the surrender value for the end of each certificate year shall be set out in the certificate;

(3) ... ;

(4) ... ;

(5) ... ;

... .

(e) ... ;

(f) ... .

(g) ... .

(h) ... .

(i) The foregoing provisions of this section shall apply to all face-amount certificates issued prior to the effective date of this subsection (June 14, 1971); to the collection or acceptance of any payment on such certificates; to the issuance of face-amount certificates to the holders of such certificates pursuant to an obligation expressed or implied in such certificates; to the provisions of such certificates; to the minimum certificate reserves and deposits maintained with respect thereto; and to the assets that the issuer of such certificate was and is required to have with respect to such certificates. With respect to all face-amount certificates issued after the effective date of this subsection, the provisions of this section shall apply except as hereinafter provided.

(1) Notwithstanding subparagraph (A) of paragraph (2) of subsection (a), the reserves for each certificate of the installment type shall be based on assumed annual, semi-annual, quarterly, or monthly reserve payments according to the manner in which gross payments for any certificate year are made by the holder, which reserve payments shall be sufficient in amount, as and when accumulated at a rate not to exceed 3-1/2 per centum per annum compounded annually, to provide the minimum maturity or face amount of the certificate when due. Such reserve payments may be graduated according to certificate years so that the reserve payment or payments for the first three certificate years shall amount to at least 80 per centum of the required gross annual payment for such years; the

reserve payment or payments for the fourth certificate year shall amount to at least 90 per centum of such year's required gross annual payment; the reserve payment or payments for the fifth certificate year shall amount to at least 93 per centum of such year's gross annual payment; and for the sixth and each subsequent certificate year the reserve payment or payments shall amount to at least 96 per centum of each such year's required gross annual payment: Provided, That such aggregate reserve payments shall amount to at least 93 per centum of the aggregate gross annual payments required to be made by the holder to obtain the maturity of the certificate. ... .

(2) Nothwithstanding paragraphs (1) and (2) of subsection (d), (A) in respect of any certificate of the installment type, during the first certificate year, the holder of the certificate, upon surrender thereof, shall be entitled to a value payable in cash not less than 80 per centum of the amount of the gross payments made on the certificate; and (B) in respect of any certificate of the installment type, at any time after the expiration of the first certificate year and prior to maturity, the holder of the certificate, upon surrender thereof, shall be entitled to a value payable in cash not less than the then amount of the reserve for such certificate required by clauses (1) and (2) of subparagraph (D) of paragraph (2) of subsection (a), less a surrender charge that shall not exceed 2 per centum of the face or maturity amount of the certificate, or 15 per centum of the amount of such reserve, whichever is lesser, but in no

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event shall such value be less than 80 per centum of the gross payments made on the certificate. The amount of the surrender value for the end of each certificate year shall be set out in the certificate.

[Sec.28(i)as added by Act of December 14, 1970, Secs. 17 and 30(3), effective June 14, 1971, 84 Stat.-.]

Sec. 42

...

(e) Whenever it shall appear to the Commission that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this title, or of any rule, regulation, or order hereunder, it may in its discretion bring an action in the proper district court of the United States, or the proper United States court of any Territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices and to enforce compliance with this title or any rule, regulation, or order hereunder. Upon a showing that such person has engaged or is about to engage in any such act or practice, a permanent or temporary injunction or decree or restraining order shall be granted without bond. In any proceeding under this subsection to enforce compliance with section 7, the court as a court of equity may, to the extent it deems necessary or appropriate, take exclusive jurisdiction and possession of the investment company or companies involved and the books, records, and

assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, who with that approval of the court shall have power to dispose of any or all of such assets, subject to such terms and conditions as the court may prescribe. ... .

Sec. 47.(a) ... .

(b) Every contract made in violation of any provision of this title ... and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title, ... shall be void (1) as regards the rights of any person who, in violation of any such provision, ... shall have made or engaged in the performance of any such contract ... .
[Amended Oct.21, 1980 in material respects, Public Law 96-477, Title I, Sec. 104, 94 Stat.2277.]

Sec. 49. Any person who willfully violates any provision of this title ... shall upon conviction be fined not more than $10,000 or imprisoned not more than five years, or both; ... .

APPENDIX B

SECURITIES AND EXCHANGE COMMISSION, Plaintiff-Appellant

v.

MOUNT VERNON MEMORIAL PARK, et al.

Defendants-Appellees.
Nos. 78-3569,79-4016

United States Court of Appeals,
Ninth Circuit.

Argued and Submitted Oct. 9, 1980.

Decided Jan. 4, 1982.

On Appeal from the United States District Court for the Eastern District of California. Before KENNEDY, PREGERSON and POOLE, Circuit Judges.

POOLE, Circuit Judge:

In this appeal, we must decide whether the Mount Vernon Memorial Park (Mount Vernon) a Sacramento cemetery and mortuary which issued debentures in connection with

the sale of its services, is an "investment company" within the meaning of the Investment Company Act of 1940 (Act),15 U.S.C.§80-a-1 et seq.[1] In a two-count complaint filed in the district court, the Securities and Exchange Commission (Commission) alleged that Mount Vernon had failed to comply with the regulatory provisions of the Act and violated provisions of the Securities Act of 1933, § 77t(b), and the Securities and Exchange Act of 1934, §§ 78u(d), 78u(e), in connection with its funeral debenture program. The district court denied the Commission preliminary injunctive relief as to both counts and the Commission filed a notice of appeal. The district court also dismissed count one (investment company claim) when it concluded Mount Vernon was not subject to regulation under the Act. The Commission

1. All further statutory section references are to Title 15, United States Code, unless otherwise indicated.

filed a notice of appeal from that determination after the district court certified its order for immediate appealability pursuant to Fed.R.Civ.P.54(b). Count two, dealing with the 33 and 34 Acts, has been settled and is not before us.

Appellees challenge our jurisdiction over the appeal from the denial of preliminary injunctive relief and urge that we sustain the district court's dismissal of count one. We dismiss the appeal from the denial of preliminary injunctive relief and reverse the district court's decision that Mount Vernon is not subject to regulation as an investment company.

I

Mount Vernon is a California corporation operating a licensed mortuary and cemetery in Sacramento, California. Appellee Foy E. Bryant was the president and principal shareholder since Mount

Vernon's incorporation and throughout the critical period at issue in this case.

In addition to the sale of its services for cash, Mount Vernon began in the mid-sixties to sell cemetery plots and funeral services on an anticipatory or "pre-need" basis. A pre-need customer would contract for purchase of a plot and a funeral service in the event of death. Under an installment sales arrangement, Mount Vernon agreed to provide a specified funeral service at a fixed price; customer was obligated to make payments spread over several years. Mount Vernon was free to use the monies received to cover its general operating expenses. If the "need" for service arose before all installments had been met, the payments made would be credited toward the price.

In October 1969, the California Attorney General issued an opinion interpreting California's Short Act, Cal.Bus. & Prof.Code § 7735 et seq., as applied to the sales of pre-need cemetery and mortuary services. He concluded that the Act required all consideration paid pursuant to installment sale funeral contracts to be held in trust until the services were actually performed. Furthermore, the opinion indicated that a refund of 90% of installment payments had to be available to any pre-need purchaser at any time under the contract arrangement. Under such an interpretation of California law, companies such as Mount Vernon could no longer use installment payment revenue to meet current operating expenses.

Mount Vernon altered its pre-need sales contract in an effort to avoid the trust fund requirements of the Short Act

promulgated in the Attorney General's decision. Exempted from the Short Act were sellers of pre-need funeral contracts who issued securities as a part of the program. Thus, once securities were registered with the California Department of Corporations, they could be offered for sale as part of a pre-need funeral program and the seller was free to use 85% of the proceeds from the sale of the debentures for any purpose, retaining only 15% in a sinking fund.

Beginning in September 1970, Mount Vernon offered "Pre-Need Funeral Service Debentures." Under the restructured program, a purchaser executed two documents: a funeral service contract and a subscription agreement. The contract obligated Mount Vernon to provide future services at a fixed price so long as the purchaser continued to make install-

ment payments toward purchase of the debentures. Under the subscription agreement, purchaser agreed to buy a certain number (equivalent to the approximate contract price for funeral services) of "Pre-Need Funeral Service Debentures," in amounts of $100 each. The debentures were interest bearing; the term of the subscription could run up to eight years. Monthly payments, which could be as low as $7.50, were accumulated by Mount Vernon until they reached the subscription price, at which time a debenture was issued. Upon default on the installment payment obligation under the subscription agreement, Mount Vernon was released from its commitment to provide funeral services at a fixed price under the contract.

Once purchased, the debentures were redeemable for funeral and cemetery services or for cash at maturity,

twenty years after purchase. If, upon the arrival of the contingency, the debentures were insufficient to cover the contract price of the services, they could be redeemed up to the amount of their value so long as the contract balance for the services were paid at the time services were rendered. The subscription agreement was cancellable at will upon notice by the purchaser. If cancelled, Mount Vernon immediately refunded only the installment payments made since the issuance of the last debenture; the balance was redeemable at maturity.

Between September 1970 and January 1975, Mount Vernon made four offerings of the debentures, each totaling one million dollars. The interest rate of the first offering was 4-1/2% while the remaining offerings provided for interest

of 3%, in each case payable either directly to the purchaser or creditable toward the next installment payment. Mount Vernon retained 15% of installment payments in a sinking fund; the remaining 85% was available to meet the company's operating expenses.

Mount Vernon discontinued its debenture contract offerings in 1975 after approximately 4,900 such contracts had been sold. In 1976, the Commission indicated in an administrative decision that it viewed debentures similar to those issued by Mount Vernon to be "face-amount certificates of the installment type," rendering issuers of such certificates investment companies by virtue of § 80a-3(a)(2). See In re International Funeral Service of California, Inc., [1975-1976 Transfer Binder] Fed.Sec.L.Rep. (CCH)¶80,363, at 85,960(1976). Shortly thereafter, the

Commission advised Mount Vernon that it considered the firm an investment company because of the outstanding funeral debentures.

In February 1976, Mount Vernon began to deposit revenue from the existing debenture contracts into a separate bank account. Thus, after paying 15% of the revenue into the sinking fund, as required by the subscription agreement, the balance has been held in this bank account, monies from which are used for investment with the profits on such investments paid to Mount Vernon.

On February 17, 1977, this suit was commenced by the Commission in the Eastern District of California. Count one alleged that Mount Vernon and Bryant violated the Act by issuing face-amount certificates of the installment type without complying with the Act's registration requirements. Count Two charged

fraudulent and materially misleading activities in connection with the sale of these debentures, in violation of the Securities Acts of 1933 and 1934.

The Commission moved for a preliminary injunction against the appellees on both counts and appellees sought dismissal of count one for failure to state a claim, theorizing that Mount Vernon was not a regulable investment company.

On April 25, 1977, the district court announced that it would not grant the Commission preliminary injunctive relief and promised to file a memorandum and order. On August 4, 1977, findings of fact and conclusions of law were filed. As to count one, the court ruled that Mount Vernon was not an investment company and therefore, not only was the Commission not entitled to injunctive relief, but count one had to be dismissed.

The court refused to grant the Commission injunctive relief as to count two because it concluded such relief was not necessary to protect the public.

On October 2, 1977, the Commission filed a notice of appeal from the denial of injunctive relief as to counts one and two. Judgment denying injunctive relief and dismissing count one was entered on October 10, 1977. On January 8, 1979, the Commission noticed a timely appeal from the dismissal of count one after the district court certified the dismissal for immediate appealability pursuant to Fed.R.Civ.P. 54(b). The two appeals were consolidated in this court for disposition and are before us now.

II

The parties have settled their differences with regard to count two, the fraud claim in the complaint, and

they agree that the appeal from the denial of preliminary injunctive relief as to that count is no longer before this court; it is dismissed as moot.

A

Appellees argue that the appeal from the denial of preliminary injunctive relief as to count one, the investment company claim, is not before us because the district court dismissed count one.[2] They contend that the denial of preliminary inuunctive relief has merged into the court's dismissal of count one and that the injunctive appeal should be dismissed. We agree.

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[2] The Commission filed its notice of appeal before formal entry of judgment denying a preliminary injunction, but after the district court had filed its findings and order denying such relief. Fed.R.App.P 4(a)(2) indicates such a notice is timely. Although this rule was not in effect when the Commission filed its notice, we have been encouraged

(continued on B-14)

The doctrine of merger has long been recognized and applied by federal courts. See, e.g., Smith v. Illinois Bell, 270 U.S. 587, 46 S.Ct. 408, 70 L.Ed. 747 (1926); Shaffer v. Carter, 252 U.S. 37, 44, 40 S.Ct. 221, 222, 64, L.Ed. 445 (1920); United States v. City of Chicago; 534 F.24 708, 711-12 (7th Cir.1976); Moore Dry Dock v. Pillsbury, 98 F.2d 115 (9th Cir.1938). The basis for the doctrine has been aptly explained by the Seventh Circuit:

> One of the considerations in entry of a preliminary injunction is the

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2 (continued)

> to apply the rule to pending cases when justice requires. 47 U.S.L.W. 4485 (1979). In any event, the entire question of the timeliness of the notice is academic because we dismiss the injunctive appeal.

> probability of the plaintiff's success on the merits. Yet on final decision, the district court has decided the merits. To attempt to review the district court's advance assessment of probabilities of plaintiff's success when the district court has now found in favor of plaintiffs on the merits seems a futile exercise. Good sense dictates that review of the decision on the merits would be more meaningful. United States v. City of Chicago, supra, 534 F.2d at 712.

Using "good sense" it is pointless for us to decide what preliminary relief the Commission should have obtained on the investment company count when that count has been dismissed for failure to state a claim and is before us on appeal.

Appeal No. 78-3569 is therefore dismissed

as merged. [3]

III

An investment company within the meaning of the Act is defined in §80a-3[4]. For our purposes, it is undisputed that Mount Vernon is an investment company if it

> is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificates outstanding[.]

§80a-3(a)(2). A face-amount certificate is defined in §80a-2(a)(15):

> "(a) When used in this subchapter, unless the context otherwise requires-
>
> (15) "Face amount certificate" means any certificate, investment contract,

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[3] Appellees also argue that if merger requires dismissal of the interlocutory appeal, the Fed.R.Civ.P54(b) certification must be remanded to the district court because it was based on the erroneous understanding that this court would consider the interlocutory appeal. We need not evaluate this argument because the settlement of count two leaves nothing

(cont'd on B-17)

Footnote 4 begins on B-18

or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance, in consideration of periodic installments of a stated or determinable amount (which security shall be known as a face-amount certificate of the installment type)[.]"

A threshold requirement for applicability of the above quoted section is that the instrument in question be a "certificate, investment, or other security." The parties do not appear to contest that the

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3 (continued)

remaining for decision in the district court and the certified appeal as to that count is therefore properly before us for decision. See Anderson v. Allstate Insurance Co., 630 F.2d 677 (9th Cir. 1980).

funeral service debentures are investment contracts or securities, and we do not find it necessary to examine the point. Appellees admit that Mount Vernon has outstanding certificates which literally fit the definition in subsection 15. They theorize, however, and the district court agreed, that the Act was intended to regulate only issuers of certificates defined in subsection 15 who use the proceeds from the sale of such certificates for reinvestment in other companies' securities and not in the issuers' own business

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[4] This section provides in relevant part:

(a) When used in this subchapter, "investment company" means any issuer which-

(1) is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities;

(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding; or

(continued on B-19)

(hereinafter "reinvestment requirement"). To give effect to this theory, several constructions of the statute are suggested: (1) The qualifying language to subsection 15, "unless the context otherwise requires," withdraws Mount Vernon's certificates from the face-amount certificate definition; (2) Any subsection (a)(2) investment company must be "in the business of issuing face-amount certificates of the installment type" and Mount Vernon is not primarily in that business; (3) Mount Vernon is exempt from the Act by virtue of §80a-3(b)(1) which provides:

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4 (continued)

(3) is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis.

"(b) Notwithstanding paragraph (3) of subsection (a) of this section, none of the following persons is an investment company within the meaning of this sub-chapter:

(1) Any issuer primarily engaged, directly or through a wholly-owned sub-sidiary, in a business or businesses other than that of investing, reinvesting, owning or holding, or trading in securities." (4) To be faithful to the legislative history, an unarticulated reinvestment requirement must be read into subsection (a)(2)."

In addition to these suggested statutory constructions, and reliance on legislative history, appellees allude to what they consider inappropriate burdens the Act would place on a small firm such as Mount Vernon.

Despite the panoply of ingenious constructions offered by appellees, the issue in this case is comparatively narrow: Did Congress intend to regulate an issuer of face-amount certificates of the installment type using the proceeds from the sale of such certificates for other than reinvestment in the securities of other companies? Upon careful analysis of the statute and its history, we believe Mount Vernon is a regulable investment company and reverse the contrary holding of the district court.

IV

It is elementary that the language of the securities laws provides the clearest indication of the regulatory sweep Congress intended. See, e.g., Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201, 96 S.Ct.1375, 1384-1385, 47 L.Ed.2d 668 (1976); Browder v. United States, 312 U.S.

335, 338, 61 S.Ct.599, 601, 85 L.Ed. 862 (1941). Appellees acknowledge, as they must, that the language of the Act provides a compelling case for classification of Mount Vernon as an investment company. Subsection (a)(2) does not purport to limit the Act's coverage based on the intended use of the money generated from the certificate sales. Quite the contrary, the language is absolute, defining an investment company as any enterprise with face-amount certificates of the installment type outstanding.

Highlighting subsection (a)(2)'s language, "in the business of issuing face-amount certificates of the installment type," appellees argue that Mount Vernon is not an investment company because its primary business is ministering to the needs of the dead and not issuing certificates. Appellees' argument would be

more plausible if the adverb "primarily" appeared in the statute. Without it, it is equally reasonable to say that any issuer is in the business of issuing certificates at least to the extent certificates are actually issued.

To require an (a)(2) issuer to be "primarily in the business of issuing certificates" would violate traditional rules of statutory construction which apply when analyzing the securities laws. SEC v. National Securities, Inc., 393 U.S. 453, 466, 89 S.Ct. 564, 571, 21 L.Ed.2d 668 (1969). Both (a)(1) and (a)(3) of the investment company definition classify issuers based on the extent to which they invest.[5]

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5 See Note 4 supra.

Subsection (a)(2) on the other hand does not refer to the number of outstanding certificates necessary to be an investment company. Indeed, it defines a face-amount investment company as one with any such certificates outstanding, whether or not the company is actively or presently engaged in selling certificates. This distinction is significant because it logically implies that Congress did not intend to quantify the activity necessary for regulation under (a)(2), as it did in (a)(1) and (3). See League to Save Lake Tahoe v. Trounday, 598 F.2d 1164, 1171 (9th Cir. 1979).

Subsection (a)(2) is also distinctive because it defines investment companies based on the type of security issued, while (a)(1) and (3) classify companies based on the disposition of the proceeds from any certificate sales. Adoption of

appellees' theory that an (a)(2) issuer has to be primarily engaged in reinvestment would render (a)(2) superfluous as an independent basis for defining investment companies, a result disfavored in the law. See e.g., United States v. Marubeni America Corp., 611 F.2d 763, 767 (9th Cir. 1980). An (a)(2) issuer primarily in the business of reinvesting would be regulable under (a)(1), and perhaps also (a)(3).

Appellees acknowledge that, absent the clause "unless the context otherwise requires" in 2(a)(15) Mount Vernon's certificates are face-amount of the installment type. But while they contend that this contextual exclusion applies to Mount Vernon's certificates, we cannot agree that the language leads to such a result. The phrase is at best neutral, with meaning only when applied to particular facts in light of Congress'

intentions.

The language of the exemption in (b)(1) also does not aid appellees argument that Mount Vernon is not regulable. If that section applied to (a)(2) issuers, it would certainly exempt companies similar to Mount Vernon, primarily engaged in other than investing. But the (b)(1) exemption applies "[n]otwithstanding paragraph (3) of subsection (a)..." Mount Vernon is regulable under (a)(2), as a face-amount company, not under (a)(3).

That the (b)(1) exemption applies only to (a)(3) issuers is apparent when this section is compared with other exemptions contained in subsection (c), which provides "[n]othwithstanding subsection (a)..." The legislative history also supports this conclusion. The (b)(1) exemption was in the originally proposed version of the Act, a version which

did not include (a)(2). In Committee testimony on the final version of the bill, the (b)(1) exemption was described as a means to insure that the formula for defining companies in (a)(3) did not catch companies primarily engaged in other than investing. See Hearings before a Subcommittee on Interstate and Foreign Commerce on H.R. 10065, House of Representatives, 76th Cong., 3d Sess.101-02 (1940) (hereinafter "House Hearings"); Hearings before a Subcommittee on Banking and Currency on S.3580, United States Senate, 76th Cong., 3d Sess.177 (1940) (hereinafter "Senate Hearings" (a)(2) was not included in the original bill).

In sum, an examination of the language and structure of the Act, though not conclusive of the issue, strongly points toward classification of Mount Vernon as an (a)(2) investment company.

V

Legislative history remains for examination. That examination is made necessary for, "'A thing may be within the letter of the statute and yet not within its spirit, nor within the intention of its makers.'" United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 849, 95 S.Ct.2051, 2059, 44L.Ed.2d 621 (1975), quoting, Church of Holy Trinity v. United States, 143 U.S.457, 459, 12 S.Ct.511, 512, 36 L.Ed.226 (1892). This is not to say that every permissble application must have been contemplated by Congress when a securities statute is adopted. Barr v. United States, 324 U.S. 83, 90,65 S.Ct.522, 525, 89 L.Ed. 765, (1945). Remedial statutes, such as the Act, must be applied in recognition of the changing dynamics of the marketplace.

See Aaron v. SEC, 446 U.S. 680, 695, 100 S.Ct. 1945, 1955, 64 L.Ed.2d 611 (1980); Affiliated Ute Citizens v. United States, 406 U.S. 128, 151, 92 S.Ct. 1456, 1471, 31 L.Ed.2d 741 (1972). But application of the Act may not run afoul of apparent congressional purposes in imposing the regulatory framework.

Due to the clear indications in the language of the Act that Mount Vernon is an (a)(2) investment company, our look at the legislative history must be tempered by the admonition'" the plainer the language [of a statute], the more convincing contrary legislative history must be"' before we depart from its apparent statutory command. Church of Scientology v. U.S. Department of Justice, 612 F.2d 417, 422 (9th Cir. 1979), quoting, United States v. United States Steel Corp., 482 F.2d 439, 444 (7th Cir.), cert. denied,

414 U.S. 909, 94 S.Ct.229, 38 L.Ed.2d 147 (1973). Congressional ambiguity or indirection may not alter the consequence or meaning of clear statutory language. See St. Paul Fire & Marine Ins. Co. v. Barry, 438 U.S. 531, 545, 98 S.Ct.2923, 2931, 57 L.Ed.2d 932 (1978); NLRB v. Plasterer's Union, 404 U.S. 116, 129-30, 92 S.Ct. 360, 368-369, 30 L.Ed.2d 312 (1971).

VI

In the Public Utility Holding Company Act of 1935, § 79z-4, Congress instructed the Commission to investigate the activities and problems of investment companies and to propose regulatory legislation. A detailed investigation lead to proposed legislation, which was subsequently modified in light of suggestions and criticism from the investment industry. It was only in this modified version of the bill

that (a)(2) appeared as part of the investment company definition. The inclusion was made "in order to eliminate any doubt that the face-amount-certificate companies are within the category of investment companies contemplated by this legislation..." House Hearings, supra, at 101.

The ultimate objective of the Act was to regulate "liquid pools of public savings entrusted to the [investment] company management for investment in productive enterprise." Note, the Investment Company Act of 1940, 50 Yale L.J. 440,440(1941). Viewing the Act in light of its broadest objectives, we acknowledge that Congress focused primary attention on companies "invest[ing] in securities of other corporations and issu[ing] securities of [their] own." United States v. National Association of Securities Dealers, 422 U.S. 694, 697-98, 95 S.Ct. 2427,

2432-2433, 45 L.Ed.2d 486 (1975).[6] But this is hardly a surprising revelation in light of (a)(1) and (a)(3), which define investment companies as those significantly engaged in the business of investing in the securities of others. Our case does not resolve itself so easily by allusions to much of the history. A more carefully focused inquiry is called for: what regulation did Congress intend for issuers of face-amount certificates of the installment type -(a)(2) investment companies?

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6 The Supreme Court's general discussion of the Act in National Association of Securities Dealers does not foreclose our further analysis of (a)(2) investment companies. The face-amount investment company considered in (a)(2) is a small distinctive part of the Act and the Court did not have occasion to consider it in National Association of Securities Dealers.

The most important piece of legislative history in analyzing (a)(2) is "A Report on Companies Issuing Face Amount Certificates," prepared by the Commission and transmitted to the House Committee on Interestate and Foreign Commerce in 1938, H.R.Doc.No.459, 76th Cong. 3d Sess. (1940)(hereinafter "Face-Amount Report"). That report is a supplement to the Report on the Study of Investment Trusts and Investment Companies. The study is an essential basis for any analysis of the Act. See § 80a-1; National Association of Securities Dealers, supra, 422 U.S. at 705-06, 95 S.Ct. at 2436-2437 (citations to the multiple parts of the study are included in this case).

This report studies the activities of several issuers of face-amount certificates of the installment type. Appellees correctly note that the face-amount

companies considered in the report are different from Mount Vernon because they used revenue from certificate sales for reinvestment. But it does not follow as appellees urge that Mount Vernon is not regulable. That theory disintegrates because it assumes that an essential characteristic of a regulable face-amount company is reinvestment of the installment sales proceeds. Yet the legislative history does not indicate that Congress intended reinvestment to be an essential requirement for face-amount companies. [7]

7.

Both the Senate and House Reports on the Act describe face-amount companies without reliance on any reinvestment requirement. See S.Rep.No.1775, 76th Cong.3dSess. 11(June 6,1940) (hereinafter "Senate Report"); H.Rep.No. 2639, 76th Cong.,3d Sess. 3, 10 (June 18, 1940) hereinafter "House Report").

And while there are parts of the legislative history alluding to the reinvestment activities of some face-amount companies, none of these references emphasizes reinvestment as a defining characteristic of such companies. Rather, we find the legislative history consistent with what the structure and language of the Act suggest, that Congress intended to regulate face-amount companies because of the type of certificates they issue or have issued--a face-amount certificate of the installment type.[8] So viewed, nothing in the legislative history to

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8 The Face-Amount Report devotes considerable attention to the characteristics of the purchasers of installment certificates; a comparison of this type of investment with others; description of the frequent lapses in payment by purchasers and the accompanying burdensome losses sustained; the dangers of undercapitalization among face-amount companies; and the general lack of understanding among many purchasers of the complete ramifications of their certificate-holder rights and obligations. See generally

(continued on B-36)

which we have been directed permits us to depart from the command of the Act.

VII

Since we have rejected Mount Vernon's theory that an (a)(2) investment company must be primarily engaged in reinvestment in other companies' securities, Mount

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8 (continued)

Face-Amount Report, supra, at 27-32, 53-74. Similar themes are repeated elsewhere in the legislative history. See Senate Report, supra, note 7 at 10-11; House Report, supra, note 7, at 8-9; House Hearings, supra at 160-61.

This recurring litany of congressional concern with face-amount installment certificates, and the plight of those purchasing them, represents the focus of congressional concern about face-amount certificates and the companies issuing them. It indicates that (a)(2) was designed to control the proliferation of face-amount certificates, not because of the reinvestment activities of issuers, but because of the nature of the certificates themselves.

Vernon cannot seriously contest that it falls within the terms of the Act.[9] We therefore reverse the judgment of the district court dismissing count one of the Commission's complaint and remand this case to that court for further proceeding consistent with this opinion.

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9 The parties in this case devoted some attention to the deference, if any, we must pay to the Commission's interpretation that issuers of funeral service debentures of the installment type are (a)(2) investment companies. Because we have independently determined that the Act is properly applied to Mount Vernon, we need not consider our proper relationship to the Commission's administrative interpretations of the Act.

Appellees have also suggested that the burdensome regulations imposed by the Act are inappropriately applied to Mount Vernon. Yet no particular (a)(2) company regulation has been specified as unfairly applied. While it is certainly true that the Act will impose administrative burdens on Mount Vernon, few regulatory schemes are without such consequences. Without specifying particular unfairness, it does not follow that because a regulation burdens the regulated it may not be imposed.

DISMISSED IN PART, REVERSED AND REMANDED.

APPENDIX C

Filed Dec.12,'77
Clerk, U.S. Dist.
Court, Eastern
Dist.of Calif.

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -v- MOUNT VERNON MEMORIAL PARK and FOY E.BRYANT, Defendants.	Civil Action No. S-77-101

STATEMENT OF INTENDED DECISION

Plaintiff Securities and Exchange Commission (S.E.C.), invoking Section 20(b) of the Securities Act [15 U.S.C. §77t(b)], Sections 21(d) and 21(e) of the Exchange Act [15 U.S.C. §78u(d) and 78u (e)], and Section 42(c) of the Investment Company Act of 1940 [15 U.S.C. §80a-41(e)], brought this action to restrain and enjoin

defendants, Foy E. Bryant and Mount Vernon Memorial Park, from engaging in future conduct in violation of the federal securities laws above. The S.E.C.'s motion for a preliminary injunction came on for hearing on the 25th day of April, 1977. Also heard at that time were defendants' motion to dismiss Count I of the first amended complaint and motion to strike certain language from Count II of that same complaint.

At the April 25th hearing the Court indicated that the motions would be taken under submission. Plaintiff S.E.C., however, interpreted commentary by the Court as a denial of S.E.C.'s motion for a preliminary injunction based on a failure to demonstrate probable success on the merits. Thereafter, the S.E.C. noticed a motion requesting this Court to assume exclusive jurisdiction over Mount

Vernon and its assets pursuant to Section 42(e) of the Investment Company Act of 1940 [15 U.S.C. §80a-41(e)]. That motion was heard on July 18, 1977. Due to defense counsel's request that he be permitted to respond to plaintiff's recent supplemental points and authorities, the parties were given additional time to file further responses, the matter thereafter being deemed submitted.

This Court having considered the complaint, affidavits, points and authorities and other papers filed by the parties and having heard the arguments of counsel, issues this Statement of Intended Decision relating to all motions referred to above.

This Court finds that Mount Vernon Memorial Park is not an "investment company" within the meaning of Section 3 (a)(2) of the Investment Company Act of

1940, [15 U.S.C. §80a-3(a)(2)]. It is the opinion of this Court that, notwithstanding the S.E.C.'s recent efforts to assume jurisdiction and supervision of California cemetery/mortuary businesses which utilize face amount certificates of the installment type to fund their pre-need funeral service contracts, Mount Vernon has not, merely by the issuance of their Pre-Need Funeral Service Debentures, become engaged "in the business of issuing face amount certificates of the installment type" as that language is used in Section 3(a)(2) of the Investment Company Act of 1940 [15 U.S.C. §80a-3(a)(2)].

This ruling is based on this Court's careful examination of the Legislative History of the 1940 Act as set forth in the points and authorities submitted by the parties. Such examination leads the

Court to the inescapable conclusion that Congress intended the extensive and onerous regulation provided for by that Act to be directed at traditional liquid investment company operations where the "investment company" issues face amount certificates of the installment type in order to create a liquid pool of capital which is in turn invested in other securities. There is no indication that Congress even contemplated including under Section 3(a)(2) those companies or businesses which utilize face amount certificates of the installment type to fund their own business operations, such as is the case with Mount Vernon.

The rationale supporting this interpretation is particularly apparent in the case at bar where the effect of holding Mount Vernon to be an investment company under Section 3(a)(2) of the 1940 Act

could effectively force Mount Vernon out of business absent either the S.E.C.'s discretionary grant of an exemption under Section 6(c) of the Act [15 U.S.C. §80a-6(c)], or a miraculous acquisition of sufficient liquid reserves to satisfy the requirements of the Act. The statutory interpretation urged by S.E.C. ultimately requires that the Act be construed as indicating a congressional intent to authorize and empower the S.E.C. to make detailed investigations of every company which has ever issued a single face-amount certificate of the installment type and, thereafter to have the right and the power to effectively force such companies out of business by denying exemptions under Section 6(c), based on the Commission's unilateral determination that the subject company is somehow financially infirm and poses a risk to the

certificate holder or holders. Such broad power was neither contemplated nor authorized by Congress at the time of the enactment of The Investment Company Act of 1940.

The S.E.C. has cited their own 1976 administrative opinion, In the Matter of International Funeral Service of California, Inc., in support of their argument that the mere issuance of a single face amount certificate of the installment type prima facie brings the issuer within the coverage of Section 3(a)(2) of the 1940 Act. That administrative decision was based on an analysis very similar to that urged by the S.E.C. in the points and authorities in the instant case. The Court has already indicated its disagreement with that rationale in the discussion above. Further, the facts involved in the International Funeral administrative decision are different than those

involved in the case at bar. First, the International case involved an application to the S.E.C. for an exemption under Section 6(c) of the 1940 Act. In that proceeding the issue of whether International in fact qualified as an investment company under Section 3(a)(2) of the 1940 Act was not argued but rather was assumed by the parties. Second, International dealt with a situation where the company wished to sell debentures, qualifying as face amount certificates of the installment type, to subscribers who could later redeem them for funeral services at whatever price was then being charged by International. Thus, the purchasers of the certificates were simply loaning money to International at a very low interest rate.

In the instant case, Mount Vernon debenture subscriptions were negotiated

together with a pre-need funeral service contract which fixed the price for the future funeral services at the rate charged at the time of the formation of the contract. Thus, although Mount Vernon debenture subscribers were also in effect lending money to Mount Vernon at a very low interest rate, they were also receiving the attendant benefit of fixing the price for future funeral services and guarding against inflation in the cost of such services. Additionally, those Mount Vernon subscribers who received the offering circulars were advised that the funds from the subscription contracts would be "used for the reduction of accounts payable and other debts of the corporation, and to supply working capital in lieu of bank credit" September 23, 1970 circular); and/or "used for the retirement of indebtedness

upon the real property of the corporation and capital improvements to such property" [June 14, 1971 circular and September 1, 1972 circular]. Such information would seemingly put subscribers on notice that the security of their funds or receipt of future funeral services is dependent on the continued financial stability of Mount Vernon. Whether the offering circulars sufficiently portrayed Mount Vernon's financial condition at the time of the subscription contracts and whether Mount Vernon has or had any duty to inform debenture subscribers of any changes in its financial condition are still open questions in this suit.

With all due respect to the Commission's interpretation of Section 3(a)(2) of the 1940 Act, and with equal respect to the abundant authority supporting the

broad interpretation of remedial legislation, the Court nonetheless finds that the construction of Section 3(a)(2) urged by the Commission, which would authorize a sweeping application of that Section, cannot be maintained. It is the opinion of this Court that the language "in the business" must be interpreted to apply only to those companies which issue face amount certificates of the installment type in securities and/or other investments separate and apart from the company's own business operations.

Plaintiff S.E.C.'s motion for a preliminary injunction to enjoin compliance with The Investment Company Act of 1940 will therefore be denied, as will the S.E.C.'s motion requesting this Court to assume exclusive jurisdiction over defendant Mount Vernon Memorial Park under Section 42(e) of the Act [15 U.S.C.

§80a-41(e)]. Defendants' motion to dismiss Count I of the first amended complaint, accordingly, will be granted.

Plaintiff S.E.C.'s motion for a preliminary injunction to enjoin violations of the Securities Act of 1933 [15 U.S.C. §77q(a)]; the Exchange Act of 1934 [15 U.S.C. §78j (b)] and Rule 10b-5 promulgated under Section 10(b) of the Exchange Act [17 C.F.R. 240.10b-5] will also be denied. While this Court believes that there may have been some earlier violations of these statutes and Rule 10b-5 during the initial solicitations of the subscription contracts, the only possible current violations which might arguably occur would be through the continued delivery of pre-need funeral service debentures pursuant to the subscription contracts which were entered into prior to the

cessation of Mount Vernon's sales efforts in January of 1976. The interests of those persons currently taking delivery of pre-need funeral service debentures are being adequately protected by Mount Vernon's voluntary practice of segregating 100% of the payments on the subscription contracts and holding them in trust pending the final resolution of this case. This denial is, of course, without prejudice to another motion for a preliminary injunction or T.R.O. should circumstances alter.

Defendant's motion to strike certain language from Count II of the first amended complaint will be denied. The language is not prejudicial where the trial on the merits will be made before the Court.

Counsel for the defendants is directed to prepare proposed findings of fact and conclusions of law and a proposed order for submission to the Court.

DATED: December 12, 1977.

/s/ Philip C. Wilkins
UNITED STATES DISTRICT JUDGE

APPENDIX D

Filed Aug.4,'78
Clerk,U.S.Dist.
Court,Eastern
Dist.of Calif.

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -v- MOUNT VERNON MEMORIAL PARK and FOY E. BRYANT, Defendants.	Civil Action No. S-77-101-PCW

FINDINGS OF FACT AND CONCLUSIONS OF LAW ON MOTION FOR PRELIMINARY INJUNCTION AND ORDER DENYING MOTION FOR PRELIMINARY INJUNCTION, GRANTING MOTION TO DISMISS, DENYING MOTION TO STRIKE, AND DENYING MOTION FOR ASSUMPTION OF EXCLUSIVE JURISDICTION

Introduction

Invoking Section 20(b) of the Securities Act of 1933, Sections 21(d) and 21(e) of the Securities Exchange Act of 1934, and Section 42(e) of the Investment Company Act of 1940 [15 U.S.C. §§77t(b), 78u(d), 78u(e) and 80a-41(e)], plaintiff

Securities and Exchange Commission (hereafter the "Commission") brings this action to have the Court restrain and enjoin defendants Mount Vernon Memorial Park (hereafter "Mt. Vernon") and Foy E. Bryant from engaging in future acts and practices which the Commission alleges to be in violation of those statutes. The Commission alleges that Mt. Vernon, a Sacramento area cemetery-mortuary business, is an investment company as defined by Section 3(a)(2) of the Investment Company Act of 1940 as a result of offering, selling and delivering "pre-need funeral service debentures" which the Commission alleges to be "face-amount certificates of the installment type" within the definition of Section 2(a) of said Act. 1/ The Commission further alleges

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1/ Investment Company Act Section 3(a) [15 U.S.C. §80a-3(a) provides in

(continued on D-3)

that, since Mt. Vernon has not registered under Investment Company Act Section 8,

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1/ continued...

pertinent part,

> "When used in this title, 'investment company' means any issuer which --
>
> ....
>
> "(2) is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificate outstanding;

Investment Company Act Section 2(a) [15 U.S.C. §80a-2(a)] provides in pertinent part,

> "When used in this title, unless the context otherwise requires --
>
> ....
>
> "(15) 'Face-amount certificate' means any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated or determinable sum or sums at a fixed or determinable date or dates more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments of a stated or determinable amount (which security shall be known as a face-amount certificate of the 'installment type'); or any

(continued on D-4)

defendants have violated and will violate Section 7(a) thereof. 2/ Finally in a

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1/ continued....

> security which represents a similar obligation on the part of a face-amount certificate company, the consideration for which is the payment of a single lump sum (which security shall be known as a 'fully paid' face-amount certificate). ...."

2/ Investment Company Act Section 7(a) [15 U.S.C. §80a-7(a)] provides:

> "No investment company organized or otherwise created under the laws of the United States or of a State and having a board of directors, unless registered under section 8 [15 U.S.C. §80a-8], shall directly or indirectly -
>
> > "(1) offer for sale, sell, or deliver after sale, by the use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be

(continued on D-5)

second count, the Commission alleges that defects in preparing and delivering offering circulars to the purchasers of such

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2/ made the subject of a public offering by use of the mails or any means or instrumentality of interestate commerce;

"(2) purchase, redeem, retire, or otherwise acquire or attempt to acquire, by use of the mails or any means of instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person;

"(3) control any investment company which does any of the acts enumerated in paragraphs (1) and (2);

"(4) engage in business in interstate commerce; or

"(5) control any company which is engaged in any business in interstate commerce.

"The provisions of this subsection (a) shall not apply to transactions of an investment company which are merely incidental to its dissolution."

pre-need debenture programs, and, after sales of the programs ceased in January 1975, failure to make continuing disclosures in connection with debenture deliveries under the pre-existing contracts resulted in violations by defendants of Section 17(a) of the Securities Act of 1933 and Rule 17 C.F.R. 240.10b-5 under Securities Exchange Act of 1934 Section 10(b). 3/ The Commission moved for a pre-

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3/ Section 17(a) of the Securities Act of 1933 [15 U.S.C. §77q(a) provides,

> "It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communications in interstate commerce or by the use of the mails, directly or indirectly --
>
> "(1) to employ any device, scheme or artifice to defraud, or
> "(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in

(continued on D-7)

liminary injunction to restrain such alleged

3/ continued...

> the light of the circumstances under which they were made, not misleading, or
> "(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceipt upon the purchaser."

Section 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. §78j(b)] provides,

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange -
>
> "(a)...
> "(b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

(continued on D-8)

violations, pending final determination of this action. Its motion was based on an Affidavit on information and belief and attached copies of documents and transcripts of private examinations and prepared statements, obtained during the formal investigation which preceded filing

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3/ continued...

And Rule 17 C.F.R. 240.10b-5 thereunder provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> "(a) to employ any device, scheme, or artifice to defraud,
> "(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> "(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceipt upon any person,
> in connection with the purchase or sale of any security."

of the Complaint. Defendants moved to dismiss the Commission's Investment Company Act count and to strike certain portions of its second count. After the hearing on these motions, the Commission filed a Motion for Exclusive Jurisdiction by the Court Pursuant to Section 42(e) of the Investment Company Act. The latter was based on the records and papers already filed and on additional allegations about a state court application for a receiver being made by the creditor on Mt. Vernon's real property indebtedness. A further hearing was held. The Findings of Fact and Conclusions of Law and the Orders set forth herein dispose of each of these motions. 4/

4/ Rule 52(a), Federal Rules of Civil Procedure, requires findings of fact and conclusions of law upon the granting or refusal of an interlocutory injunction.

(continued on D-10)

FINDINGS OF FACT

Defendants' Background

1. Defendant Mt. Vernon, a California cemetery corporation, was first incorporated on March 29, 1963. It has been a Cemetery Authority of the State of California since July 8, 1964. It has held a funeral director's license from the State of California, either directly or through a wholly-owned subsidiary, since December 3, 1965. Since December 1965 it has been and is engaged in the business of providing funeral and burial services, burial spaces, and related items at its cemetery and mortuary located in Fair Oaks, Sacramento, California, and it

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4/ continued...

The facts set forth in these Findings are either matters of documentary record or are not disputed by the parties.

has been and is primarily engaged in said business.

2. The Mt. Vernon business was conceived and developed principally by defendant Foy E. Bryant. From its incorporation in 1963 to September 1969, Mr. Bryant held approximately 49% of Mt. Vernon's stock. From September 1969 to December 1971, all of its stock was held by Zenith Funding Corporation which had its offices in Los Angeles. Mr. Bryant acquired all of Mt. Vernon's stock in December 1971. He has been its President and a member of its Board of Directors, and he has managed Mt. Vernon's everyday operations since its incorporation in 1963. 5/

5/ Mr. Bryant was born in 1913. He left the tenth grade in high school, was employed at various farming, oil field and industrial jobs until the early 1950s, attended bible college, and then worked as a minister in Healdsburg, Calif. until he had to discontinue

(continued on D-12)

Mt. Vernon's Pre-Need Funeral Service and Pre-Need Funeral Service Debenture Program

3. In its funeral service business, Mt. Vernon has utilized two types of contractual arrangements -- one, referred to as "at need", consists of providing services for those who are deceased; and the other, referred to as "pre-need" or "advance of need" obligates Mt. Vernon to provide specified services in the future at a presently agreed upon price. Customarily, purchasers of advance of need arrangements make the payment in small, monthly installments.

4. During the period beginning in

5/ continued...

there because of his wife's health. Because of a back disability, his attempt to return to industrial work was not successful. From 1954 to 1958 he was employed as a cemetery salesman. From 1958 to 1962 he was employed as a salesman for a Sacramento firm selling insurance, mutual funds and over-the-counter securities. In response to the

(continued on D-13)

September 1970 and ending in early January 1975, Mt. Vernon followed a practice of entering into subscription agreements for Pre-Need Funeral Service Debentures in conjunction with its agreements for pre-need funeral and burial services. Under these joint contractual arrangements, such Debentures may be converted into payment for the specified services Mt. Vernon has agreed to provide at the rate charged for such services at the time of formation of the contract. If the Debentures are not converted into the agreed upon payment for the specified funeral services and are not otherwise redeemed, they are payable in a stated sum of cash

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5/ continued...

Commission's special allegation of the latter, Mr. Bryant replied that the job did not require an extensive knowledge of securities matters and that he has relied on accountants in matters of financial reporting. In 1962 he began his attempts to develop Mt. Vernon.

on a fixed date which is approximately 20 years after the first offering. The practice of making payment in small, monthly installments was continued.

5. Mt. Vernon registered these Debentures and subscription agreements with the California Department of Corporations which issued a series of permits authorizing their sale to California residents in four separate offerings, each in the total amount of $1,000,000. Mt. Vernon issues the Debentures pursuant to the terms of indentures under which it is required to pay each year into a sinking fund maintained by Title Insurance & Trust Company of Los Angeles, as trustee, 15% of the principal amount outstanding on July 1, and an increased amount in years after 1980. The Debentures outstanding bear interest at the rates of 4-1/2% per annum for the first offering and 3% per annum

for each of the remaining three offerings.

6. These pre-need funeral service and Pre-Need Funeral Service Debenture arrangements were offered by Mt. Vernon sales personnel licensed by the California Department of Corporations by means of personal calls on prospective purchasers in the Sacramento area. Between 4,900 and 5,000 purchasers had entered into such contracts with Mt. Vernon during the period from September 1970 to early January 1975. Although the offerings ceased in early 1975, Mt. Vernon has continued to receive installments and to issue Debentures therefor on contracts entered into prior to that time. As of November 30, 1976, the cumulative amount of such Debentures subscribed for (net of conversions and redemptions) totaled approximately $2.85 million, and the amount of Debentures issued and outstanding total approximately

$2.27 million.

7. Mt. Vernon's sales personnel were required to deliver offering circulars on file with the California Department of Corporations to purchasers of such contracts. 6/ Mt. Vernon's financial

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6/ The Commission contends that whether each of the debenture purchasers received an offering circular from Mt. Vernon is a material, unresolved question of fact. Defendants have pointed out that the form of agreement used by Mt. Vernon sets forth a written acknowledgement of the receipt of such an offering circular by the signing purchaser. Declarations of Mr. Bryant and of Mt. Vernon sales personnel state that a sufficient number of such circulars were made available, that sales personnel were continually and periodically instructed to deliver them, and that defendants believe such instructions were followed. It is not to be implied from these Findings whether an offering circular was or was not received by each purchaser.

statements appearing in these offering circulars were prepared with the assistance of a firm of certified public accountants. The first of these offering circulars notified the purchasers who received them that the net proceeds of that offering would be "used for the reduction of accounts payable and other debts of the corporation, and to supply working capital in lieu of bank credit". The remaining three offering circulars notified the purchasers who received them that the net proceeds of said offerings would be "used for the retirement of the indebtedness upon the real property of the corporation and capital improvements to such property".

8. Mt. Vernon's Pre-Need Funeral Service Debenture program was modeled after similar programs being used by other cemetery-mortuary complexes in the State of California. It was prepared and first

registered with the Department of Corporations with the advice and assistance of reputable legal counsel.

9. Mt. Vernon has not filed a Notification of Registration under Section 8 of the Investment Company Act of 1940 [15 U.S.C. §80a-8]. The telephone and the mails are regularly used in Mt. Vernon's business, including receipt of installment payments and delivery of certain of the Debentures by mail.

The Commission's International Funeral Services Opinion and Subsequent Events

10. On January 5, 1976, the Commission rendered an administrative decision In the Matter of International Funeral Services of California, Inc., Investment Company Act Release No. 9112 [1975-76 CCH Federal Securities Law Reptr., ¶80, 363], refusing to grant an application for an exemption from the Investment Company

Act for the proposed offer of certain described pre-need funeral service debentures by the applicant in that proceeding. Thereafter Mt. Vernon and other California cemetery-mortuary operators which had employed pre-need funeral service debentures were advised by the Commission staff that it took the position that, as a result of offering and issuing "pre-need funeral service debentures", they were investment companies under the Investment Company Act of 1940 by reason of its "face-amount certificate" provisions. It appears that this was the first time such a position had been taken.

11. As a result, Mt. Vernon had adopted the practice of setting aside 100% of all funds received frc Pre-Need Funeral Service Debentures since early 1976, when the above cited Commission decisicn became effective. Defendants repre-

sent that Mt. Vernon has continued to set such funds aside up to this time and that Mt. Vernon has since been unable to make further payments on its real property indebtedness.

12. On September 27, 1976 the creditor on said debt, the Teamsters' Union Central States Pension Fund, filed an action in the California Superior Court for Sacramento County seeking, among other things, to collect the debt due and to foreclose its security interest in Mt. Vernon's property. Between April and June 1977, the attorneys for said pension fund applied to the Superior Court to appoint a receiver to specifically enforce a provision in the trust deed for payment to it of the "rents, issues and profits" of the secured property.

13. On July 6, 1977, the Superior Court ruled on that pension fund applica-

tion by entering an "Order Creating Limited Receivership" for Mt. Vernon's current receipts, subject to further order of that Court. Said Order recites that the limited receivership is subject to the requirements for placing the proper amounts of such receipts in trust under California statutes and regulations and of Mt. Vernon's existing practice of placing 100% of the funds received from its pre-need funeral service debenture customers in trust and subject to that Court's direction to take all reasonable steps to allow the continuance of Mt. Vernon's existing business.

14. Defendant Bryant has represented that he is in the process of attempting to obtain additional capital for Mt. Vernon through a proposed sale to persons having both substantial financial resources and substantial experience in the funeral

business. Mt. Vernon's business has continued in operation.

The Circumstances Do Not Constitute A Showing For A Preliminary Injunction

15. It cannot be shown, as required by Investment Company Act Section 42(e) 7/ , that defendants have engaged or are about to engage in acts or practices in violation of Section 7(a) of that Act because Mt. Vernon has not been and is not an investment company. 8/

7/ Section 42(e) [15 U.S.C. §80a-41(e)] in pertinent part provides for an injunction upon showing that any person has engaged or is about to engage in any act or practice in violation of the Investment Company Act.

8/ Investment Company Act Section 7(a) [15 U.S.C. §80a-7(a)] is set forth at note 2 supra.

Mt. Vernon has not been, is not, and does not propose to be engaged "in the business of issuing face-amount certificates of the installment type" within the meaning of that quoted language appearing in Investment Company Act Section 3(a)(2). 9/ Mt. Vernon has been and is operating a cemetery-mortuary and has not been held out to the Debenture purchasers as being engaged in the business of investing. 10/

9/ Section 3(a)(2) [15 U.S.C. §80a-3(a)(2)] is set forth at note 1 supra. The meaning of this language is discussed in Conclusions of Law numbered 2 through 10 infra.

10/ Those Debenture purchasers who received offering circulars were put on notice that the Debentures proceeds would be used for purposes of Mt. Vernon's business (See Finding of Fact No. 7 supra).

Absent this finding that Mt. Vernon is not an investment company, the circumstances set forth in Findings No. 16 and No. 17 infra would be material to preliminary relief under Investment Company Act Section 42(e) [15 U.S.C. §80a-41(e)], as well.

16. Further, the total circumstances before the Court do not constitute a sufficiently clear showing under Securities Act Section 20(b) and Securities Exchange Act Section 21(d) that defendants are engaged to the detriment of the public interest in any of the Securities Act and Securities Exchange Act violations sought to be enjoined or that there is a reasonable likelihood that defendants will engage in such violations pending the trial of this action. 11/ Since the required showing has not been made by a pre-

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11/ Under Securities Act Section 20(b) and Securities Exchange Act Section 21(d) [15 U.S.C. §§77t(b) and 78u(d)], an injunctive action is authorized when any person "is engaged" or "about to engage" in acts or practices constituting a violation of those statutes or the rules thereunder. See also Conclusions of Law nos. 11 and 12.

Securities Exchange Act Section 21(e) [15 U.S.C. §78u(e)] provides for writs of mandamus and is not applicable to this motion for Preliminary Injunction.

ponderance of the evidence, it is not necessary for purposes of this Motion to determine whether the Commission's Securities Act and Securities Exchange Act claims are required to be shown by a greater standard of proof. 12/

12/ Federal Courts have held that the burden of proof is on the Commission to show the necessity for a preliminary injunction by proof which is clear [S.E.C. v. Griffin, 296 F.Supp. 883, 887 (S.D.Miss., 1968), cited as a definitive statement in S.E.C. v. Continental Tobacco Co. 463 F.2d 137, 162 (C.A.5, 1972)]. In Collins Securities Corp. v. S.E.C., 562 F.2d 820, 823-827 (C.A.D.C., 1977), an appeal from an administrative finding by the Commission of anti-fraud violations, the Court held that a "preponderance of the evidence" was not the correct standard of proof where anti-fraud violations were charged and substantial consequences would result. The Court remanded the case to the Commission for reconsideration under the "clear and convincing evidence" standard. The Court also requested the Commission to re-evaluate that case in the light of recent and significant Supreme Court precedents such as Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) and Santa Fe

(continued on D-26)

17. The Court is mindful that in assessing the circumstances for injunction under the Federal securities laws, the need to enforce those laws should receive special emphasis. However, under the circumstances shown here, Mt. Vernon's continued voluntary setting aside in trust of all funds received for Pre-Need Funeral Service Debentures since February 1976 weighs most heavily. Setting such funds aside in trust pending final resolution of this case adequately protects the interests of the persons to whom Mt. Vernon Debentures are currently being issued since, while there may have been some earlier violations of the above statutes and Rule 10b-5

12/ continued...

Industries v. Green, 430 U.S. 462 (1977). This and other legal and factual issues raised by Count Two of the Complaint are still open questions in the instant case.

during the initial solicitations (depending on what the evidence will show at trial), the only continuing practice after the Debenture program offerings ceased in January 1975 has been accepting installment payments and issuing Debentures on Mt. Vernon's previous commitments. 13/ The Commission's contentions that defendants have engaged in practices which should be enjoined pursuant to Securities Act Section 20(b) and Securities Exchange Act Section 21(d) can safely await trial. Should the circumstances materially alter pending trial, the Commission may again move for a temporary restraining order or preliminary injunction.

13/ It is noted that, during the post-subscription period and a substantial time before the filing of this action, reports of the state court foreclosure action filed against Mt. Vernon had been published in the local press.

CONCLUSIONS OF LAW

Jurisdiction

1. This Court has jurisdiction to hear this action under the provisions of Securities Act Section 22(a), Securities Exchange Act Section 27, and Investment Company Act Section 42 [15 U.S.C. §§77v(a), 78aa, and 80a-43].

Investment Company Act of 1940 Section 3(a)(2)

2. The Commission contends that pre-need funeral service debentures are literally face-amount certificates of the installment type within Section 2(a)(15) of the Investment Company Act and, in effect, that the offer, sale, or delivery of a single debenture means any issuer thereof is an investment company by reason of Section 3(a)(2) of said Act. 14/ During

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14/ 15 U.S.C. §§80a-2(15) and 80a-3(a)(2). The text of these sections appears at note 1 supra.

the thirty-five years prior to the publication of the Commission's administrative opinion In the Matter of International Funeral Services of California, Inc. 15/, there had been no judicial decisions and no published administrative interpretations indicating that an operating company such as Mt. Vernon would be within the scope of the Act by reason of Section 3(a)(2) thereof. 16/ In the context of the entire

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15/ Cited in Finding No. 10 supra, 1975-76 CCH Federal Securities Law Reporter ¶ 80,363.

16/ There is public reference to only one other S.E.C. court action against an unregistered investment company under Investment Company Act Section 3(a)(2) -- S.E.C. v. Guarantee Income Trust et al., a 1943 injunctive action in the then District of Oklahoma. The defendants in that case consented to an injunction [S.E.C., Ninth Annual Report (1943), p. 55].

Act, the meaning of Section 3(a)(2) asserted by the Commission is not clear. 17/

17/ As stated in L. Loss, Securities Regulation (1961 ed. and 1969 Supplement), Vol. 1, p. 144,

> "The Investment Company Act, like the Holding Company Act, is definitely a regulatory act for an industry which was thought to require something more than the disclosure treatment of the 1933 and 1934 acts. Investment companies -- or 'investment trusts' as they are often popularly termed -- engage primarily in the business of investing and reinvesting in securities of other companies. They are basically institutions which provide a medium for public investment in pools of corporate securities. Their raison d'etre is diversification of risk. In theory, they are the 'poor man's' investment counselors. In origin largely Scottish via Boston, they have emerged as an important element in the financial world only within the last thirty-five years."

Also, Section 3(b)(1) of the Investment Company Act [15 U.S.C. §80a-3(b)(1)] provides:

> "Notwithstanding paragraph (3) of subsection (a), none of the following persons is an investment company within the meaning of this title:
>
> "(1) Any issuer primarily engaged directly or through a wholly-owned subsidiary or subsidiaries, in a business other than that of investing, rein-

(continued on D-31)

With this in mind, the Court has carefully examined the legislative history.

3. As an outgrowth of the Report of the Securities and Exchange Commission on Investment Trusts and Investment Companies, [18] on March 14, 1940, identical bills proposing investment company regu-

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17/ continued...

vesting, owning, holding, or trading in securities.
...."

(See House Hearings, cited at note 25 infra., p. 102)

In addition, the regulation provided for in the Act is most appropriate for application to liquid pools of capital obtained from public investors for the purpose of, in turn, investing in other enterprises and investments (See Conclusion of Law No. 8 infra.).

18/ Section 30 of the Public Utility Holding Company Act of 1935 (15 U.S.C. §79z-4] had authorized and directed the Commission to study and report to Congress on the functions and activities of "investment trusts and investment companies". The overall Report was submitted to Congress in a series of parts, chapters and supplements as follows:

(continued on D-32)

18/ continued...

Part One, submitted June 10, 1938, "The Origin, Scope of Conduct of the Study, Nature and Classification of Investment Trusts and Investment Companies, and the Origin of the Investment Trust and Investment Company Movement in the United States" [H.R. Doc. No. 707, 75th Cong., 3rd Sess. (1939)];

Part Two, submitted March 10, 1939, "Statistical Survey" [H.R. Doc. No. 70, 76th Cong., 3rd Sess. (1939)];

Part Three, Chapters I and II submitted August 7, 1939, Chapters III, IV, and V submitted December 29, 1939, Chapter VI submitted September 10, 1940, "Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies" [H.R. Doc. No. 279, 76th Cong. (1941)];

Part Three, Chapter VII published on February 24, 1941, "Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies" [H.R. Doc. No. 136, 77th Cong. (1941)].

Six supplements of substantially lesser length were submitted to Congress as follows:

(continued on D-33)

18/ continued...

Date of Submission	Subtitle
June 26, 1939	"Investment Trusts in Great Britain" [H.R. Doc. No. 380, 76th Cong., 1st Sess. (1939)];
August 17, 1939	"Investment Counsel, Investment Management, Investment Supervisory and Investment Advisory Services" [H.R. Doc. No. 477, 76th Cong., 2nd Sess. (1939)];
August 30, 1939	"Co-mingled or Common Trust Funds Administered by Banks and Trust Companies" [H. R. Doc. No. 476, 76th Cong., 2nd Sess. (1939)];
Sept. 22, 1939	"Companies Sponsoring Installment Investment Plans" [H.R. Doc. No. 482, 76th Cong., 2nd Sess. (1940)];
January 15, 1940	"Fixed and Semi-fixed Investment Trusts" [H. R. Doc. No. 567, 76th Cong., 3rd Sess. (1940)];
March 13, 1940	"Companies Issuing Face Amount Installment Certificates" [H.R. Doc. No. 659, 76th Cong., 3rd

(continued on D-34)

lation were introduced in the United States Senate and House of Representatives. 19/ In April 1940, a Senate subcommittee held four week of hearings at which representatives of the then investment company industry appeared and objected to various provisions of the proposed legislation. 20/ The hearings adjourned

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18/ continued...

Sess. (1940)].

Parts Four and Five were published under date of June 9, 1941, [H.R. Doc. No. 246, 77th Cong., 1st Sess. (1942)]. Part Four was entitled "Control and Influence Over Industry and Economic Significance of Investment Companies Part Five was entitled "Conclusions and Recommendations".

19/ S. 3580 and H.R. 8935, 76th Cong., 3rd Sess. (1940).

20/ Hearings before a subcommittee of the Committee on Banking and Currency of the United States Senate on S.3580, 76th Cong., 3rd Sess. (1940), Parts One and Two.

for the express purpose of allowing these industry representatives to work out a joint recommendation with the Commission as to the scope and provisions of the proposed legislation. [21] After resumption of the Senate subcommittee hearings on May 31 and June 4, 1940, a redrafted bill recommended by both the industry representatives and the Commission was introduced in the Senate [22] and received a favorable report from the Senate Committee. [23] A companion bill was then intro-

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21/ Idem Part 2; Senate Report cited at note 2 infra., p. 1; House Report cited at note 26 infra., pp. 4-5.

22/ Senate Hearings supra, Part 4; the redrafted bill was designated S. 4108, 76th Cong., 3rd Sess. (1940).

23/ Report of the Senate Committee on Banking and Currency to accompany S. 4108, Senate Report No. 1775, 76th Cong., 3rd Sess. (June 6, 1940).

duced in the House. 24/ Brief hearings were held before a House subcommittee on June 13 and 14, 1940. 25/ The House Committee also reported favorably. 26/ The redrafted bill was passed 27/ and became law on August 22, 1940. 28/

24/ H.R. 10065, 76th Cong., 3rd Sess. (1940).

25/ Hearings before a subcommittee of the Committee on Interstate and Foreign Commerce on H.R. 10065, House of Representatives, 76th Cong., 3rd Sess. (1940).

26/ Report of the Committee on Interstate and Foreign Commerce of the House of Representatives to accompany H.R. 10065, House Report No. 2637, 76th Cong., 3rd Sess. (June 18, 1940).

27/ See 86 Cong. Rec. 9807-9819, 10069, 10071 and 10249-51 (1940).

28/ Public Law No. 768, 76th Cong., 3rd Sess. which is divied into three titles. Title I is addressed to investment companies and is separately known as the Investment Company of 1940. Title II refers to investment advisers. Title III was a technical amendment to Securities Act Sec. 8(a) [54 Stat. 789.].

4. There is no indication in the legislative history that the Commission staff, the representatives of the investment company industry, or the Congress had any intention that by means of Section 3(a)(2), the Investment Company Act could be applied to operating companies such as the cemetery and funeral services company in this case.

5. The Senate and House Committee Reports state that the problems of investment companies, as shown by the Report of the Commission and the subcommittee hearings, basically flowed from the very nature of their assets which invariably consisted of cash and securities -- assets which are comparatively liquid, mobile, and readily negotiable. 29/ These reports also indicate that investment trusts and

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29/ House Report cited at note 26 supra, p. 7; Senate Report cited at note 23 supra, p. 6.

investment companies were considered essentially to be institutions which provide a medium for public investment in common stocks and other securities. 30/

6. The focus of the Commission's Report on Investment Trusts and Investment Companies had been on abuses in the formation and management of large, liquid pools of capital formed when public investors invested in organizations which were in the business of, in turn, investing. To supplement to the Commission's overall report subtitled "Companies Issuing Face-Amount Installment Certificates" reported on companies which were intended to be within the scope of Investment

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30/ [illegible] Report supra, p. 6; Senate Report supra, p. 2.

Company Act Section 3(a)(2). 31/ Each of the companies reported on in that supplement was engaged in the business of in turn investing, holding, and reinvesting in securities and similar investment properties. As such, they were the companies under consideration in the subsequent Congressional hearings and the resulting committee reports. 32/

7. The face-amount certificates of the installment type considered in that supplement, in the subsequent Congressional hearings, and in the resulting committee reports were simply and essentially evidences of indebtedness issued by such

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31/ The citations to this and the other segements and supplements making up the Commission's Report on Investment Trusts and Investement Companies appears at note 18 supra.

32/ The Commission's 267 page face amount Certificate Company Supplement reported on three face amount certificate companies and reviewed only two of them in any detail (Supplement on

(continued on D-40)

32/ continued...

Companies Issuing Face Amount Installment Certificates supra, p. 2).

Abuses specifically attributed to these face amount installment certificate type of investment companies included widespread sales of their certificates on the basis of misleading comparisons to savings bank deposits and insurance policies. The Supplement reported that in many cases small investors would start such contracts, make some payments, and then have to quit. This "lapse experience" would be particularly high during the first and second years when the certificate had no surrender value. Also, the investor would be deprived of any interest return on his entire investment during any time that he was in default on his installments, no matter how much he had paid in. The companies in question were then able to use this money to offer higher rates of interest and derive higher profits for themselves. (Supplement on Companies Issuing Face Amount Installment Certificates supra, pp. 27-29, 55-70, 91-92 and 108-117; See also House Hearings supra, p. 61).

One of the Commission's drafters testified that proposed Section 3(a)(2) was inserted to specifically enumerate these face amount certificate companies as investment companies in order to eliminate any doubt that they were within the category of investment companies contemplated by the legis-

(continued on D-41)

companies for the investment or savings of money with only money to be returned if the purchaser had promptly and without delinquency made all the required payments. 33/ There is no indication that

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32/ continued...

lation (House Hearings supra, p. 101).

A further indication that it was these specific types of companies which were intended to be the subject of Section 3(a)(2) was the role accorded to representatives of then existing investment companies in the face amount certificate business in the Congressional hearings and the negotiations with the Commission staff which resulted in this compromise legislation (Senate Hearings, supra, pp. 1128-29; Senate Report supra, p. 1; House Hearings supra, p. 63; House Report supra, pp. 4-5).

33/ Supplement on Companies Issuing Face Amount Installment Certificates supra, pp. 1 and 2; Senate Report supra, p. 10; House Hearings supra, p. 57, 67; House Report supra, p. 57.

For the purpose of enumerating the obligations of a face amount certificate company to a certificate holder who is in default in his installments, the proposed Investment Company Act required these face amount installment certificates to contain specific

(continued on D-42)

the proposed Investment Company Act was intended to regulate situations in which the installment feature might be a part of contracts with companies not in the investment business and which have additional, different purposes, such as Mt. Vernon's pre-need and debenture arrangements presently agreeing upon a future price for future services. 34/

33/ continued...

provisions concerning cash surrender values, liability of certificate holders for unpaid installments (Provisions for such liability are made unlawful.), and options to convert to paid-up certificates. Sections 28(d), (e), and (f) [15 U.S.C. §§80a-28(d), (e) and (f)].

34/ The Commission's contention that Mt. Vernon's pre-need funeral service debentures are literally within the definition of face amount certificates of the installment type set forth in Investment Company Act Section 2(a)(15) [15 U.S.C. §80a-2(a)(15)] impels that note be taken of the phrase "unless the context otherwise requires" set forth as a qualification of all the definitions in said Section 2(a) [See Footnote 1 supra.].

(continued on D-43)

8. Further, the extensive and detailed regulatory framework established by the Investment Company Act specifically prescribed and closely limited the operation of registered investment companies in a manner which would be inappropriate and onerous if applied to companies which must use non-liquid assets in their business. 35/ The Act enumerates specific

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34/ continued...

In Lino v. City Investing Company, 487 F.2d 689, 695 (C.A.3, 1973), a case under the definition of "security" in the Securities Act of 1933, the Court recognized that the phrase "unless the context otherwise requires", qualifying the definitional section of the Securities Act, indicated that a literal application of that definitional section to the instruments under consideration was not mandated where the instruments were of the type not intended to be covered by that legislation.

35/ Among other things, the proposed Investment Company Act:

1. Required a net worth of at least $100,000 for most investment companies, and a capital of $250,000 in cash for the face amount certificate type of

(continued on D-44)

35/ continued...

investment company [Sections 14(a) and 28(a)(1);

2. Set up, in addition to minimum net worth requirements, minimum reserve requirements for face amount certificate type investment companies in excess of 90% of all installment payments after the first year, which must accumulate at the rate of 3-1/2% a year compounded annually, and required the capital and reserves of such face amount certificate companies to be maintained at all times in cash or securities qualified for life insurance companies under the District of Columbia Code [Section 28(a),(b) and (c)];

3. Regulated the details of an investment company's capital structure, dividends and capital gains distributions, and made it unlawful for the face amount certificate type company to issue any securities other than face amount certificates, short term financing instruments, and common stock [Sections 18, 19, and 18(j)];

4. Set forth detailed restrictions on the mechanics of how such companies may issue and sell securities, including minimum purchase and maximum sales prices, persons to and through whom such securities may be sold, and what such securities may be sold for [Sections 22 and 24];

5. Prohibited voting trusts and "cross

(continued on D-45)

undesirable conditions concerning the formation, operation, and securities of "investment companies", and provides that it shall be interpreted in accordance with the Congressional policy to remedy those conditions.

35/ continued...

ownership" (as defined) involving more than 3% of their voting securities [Section 20];

6. Prohibited transactions involving "affiliated persons" of such companies (as that term is defined in the Act), unless approved in advance by the Securities and Exchange Commission [Section 17];

7. Prohibited more than 40% of their Directors from being persons interested (as that term is defined in the Act) in the company and required their "independent public accountants" to be approved by the "independent members of their Boards of Directors" [Sections 10(a) and 32];

8. Required them to get permission from the Securities and Exchange Commission before they may cease to be in business as an investment company [Section 8(f)];

9. And made it unlawful for any person to be employed by or participate in the

(continued on D-46)

conditions. 36/ Each of the conditions so enumerated presupposes the existence of an "investment company". 37/

35/ continued....

management of such a company who has been permanently or temporarily enjoined by a court from engaging in any conduct in connection with the purchase or sale of any security [Section 9(a)(2)].

36/ Section 1 [15 U.S.C. §80a-1].

37/ The Commission makes a supplemental contention that the scope of Section 3(a)(2) must be construed to include Mt. Vernon in order to remedy the condition enumerated in Section 1(b)(8). The latter provides in essence that the Act must be interpreted to eliminate the operation of investment companies without adequate assets or reserves. As indicated above, the condition described in Section 1(b)(8) presupposes the existence of an investment company.

9. While respect is accorded to the abundant authority for the principle that remedial legislation is to be broadly construed to effectuate its purposes, there is no indication of a Congressional purpose to directly apply the broad strictures and regulations of this statute to businesses outside the investment company field. There is no indication that Congress even contemplated including under Section 3(a)(2) those companies or businesses which utilize instruments which have features coinciding with the description of the face amount certificates of the installment type to fund their own business operations, such as is the case with Mt. Vernon. 38/

38/ In addition, there is no long-standing administrative interpretation lending support to the statutory construction urged by the Commission. The Commission announced a viewpoint similar to its contention here for the first time in its 1976 adminis-

(continued on D-48)

38/ continued...

trative opinion In the Matter of International Funeral Services of California, Inc. (cited in Finding of Fact No. 10, supra, 1975-76, CCH Federal Securities Law Reporter ¶80,363). This Court's disagreement with the Commission's analysis in that case is apparent. Further, the factual situation in International was materially different from the case at bar. Whether International was in fact an investment company under Section 3(a)(2) of the Act was assumed by the Commission for purposes of the Section 6(c) exemption application which was litigated in that matter. Second, International concerned a situation in which the applicant for the Section 6(c) exemption wished to sell instruments denominated pre-need funeral service debentures to subscribers who could later redeem them for funeral services at whatever price would then be charged by the applicant. Thus, the certificate purchasers would simply be loaning money to International at a very low interest rate and not obtaining the benefits of a presently set price for future funeral services at the rates charged at the time of formation of the contract.

10. The conclusion is inescapable that Congress intended the regulation provided for in the Investment Company Act to be directed at traditional, liquid investment company operations where the "investment company" issues face amount certificates of the installment type in order to create a pool of capital which is in turn invested in securities or other investment properties. The language "in the business" in Section 3(a)(2) must be interpreted to apply only to those companies which issue face amount certificates of the installment type to generate capital which is thereafter to be reinvested in securities and/or other investment properties separate and apart from the company's own business operations. 39/

F/N 39 continued on D-50

Requirements For An S.E.C. Injunction Under the Securities Act And The Securities Exchange Act

11. Securities Act Section 20(b), as well as Securities Exchange Act Section 21(d) (15 U.S.C. §§77t(b) and 78u(d)], authorizes, but does not require, a temporary or permanent injunction or restraining order when the person sought to be enjoined is engaged or about to engage in acts or practices in violation of these statutes or of rules thereunder. 40/

39/ It is the duty of the courts to declare that, "however broad the language of the statute may be, the act, although within the letter, is not within the intention of the legislature, and therefore cannot be within the statute." Church of the Holy Trinity v. United States, 143 U.S. 457 (1986); United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975).

40/ S.E.C. v. Griffin, cited at Footnote 7, supra, 296 F. Supp at 887.

The applicant for such an injunction has the burden of showing the necessity for it. 41/ And the issuance of such an injunction requires positive proof, based on the totality of the circumstances, of a reasonable likelihood that past wrongdoing will recur. 42/

12. Such statutory provisions hardly evidence a Congressional intent to foreclose equitable considerations by the district court in determining whether there has been a "proper showing" for an injunction. Hecht Co. v. Bowles, 321 U.S. 321, 328-31 (1944); S.E.C. v. Management Dynamics, Inc., 515 F.2d 801, 808 (C.A.2, 1975). However, a further showing of irreparable injury is not a prerequisite. 43/

42/ S.E.C. v. Bausch & Lomb, Inc., 565 F.2d 8, 18-19 (C.A.2, 1977).

43/ S.E.C. v. Management Dynamics, Inc. supra, 515 F.2d at 808.

And where there is a strong showing that future violations are likely, the district court will exercise its equitable discretion with the public interest, rather than the requirements of private litigation, in view, giving special emphasis to the need to enforce the Federal securities laws. 44/ On the other hand, in a case such as this, where the showing that future violations are likely is not as clear, the district court will attach greater weight to traditional equitable principles in arriving at its conclusion. See S.E.C. v. Management Dynamics, Inc., supra, 515 F.2d at 809, n.5.

44/ S.E.C. v. Management Dynamics, Inc., supra, 515 F.2d at 806-809

ORDERS

Accordingly, for good cause shown and the Court being fully advised in the premises, the following orders are now entered.

On the basis of the above Findings of Fact and Conclusions of Law, it is

ORDERED that the Commission's Motion for Preliminary Injunction be and it is hereby denied.

On the basis of the above finding that defendant MOUNT VERNON MEMORIAL PARK has not been and is not an investment company within the meaning of Investment Company Act of 1940 Section 3(a)(2) and the Court being further of the view that it would not be necessary or appropriate to take exclusive

jurisdiction over said defendant pursuant to Section 42(e) of said Act [15 U.S.C. §80a-41(e)] [45/], it is

FURTHER ORDERED that the Commission's Motion for the Assumption of Exclusive Jurisdiction be and it hereby is denied.

Upon consideration of the First Amended Complaint and defendant's Motion to Dismiss Count One thereof, it is

FURTHER ORDERED that the said Motion to Dismiss be and it hereby is granted.

45/ Section 42(e), inter alia, authorizes the Court, to the extent it deems necessary or appropriate, to take exclusive jurisdiction and possession of an unregistered investment company.

And upon consideration of defendant's Motion to Strike certain portions of Count Two of the Commission's Complaint and the Court being of the view that, since the trial on the merits will be before the Court, the language sought to be stricken will not be prejudicial, it is

FURTHER ORDERED that defendants' said Motion to Strike be and it hereby is denied.

DATED: August 2, 1978 .

at Sacramento, California

/s/ Philip C. Wilkins

UNITED STATES DISTRICT JUDGE

APPENDIX E

INVESTMENT COMPANY ACT

ALLEGATIONS BY THE S.E.C.

Filed
Mar 17,1977
Clerk, U.S.
District Crt.
Eastern Dist.
of California

UNITED STATES DISTRICT COURT

EASTERN DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, -v- MOUNT VERNON MEMORIAL PARK and FOY E. BRYANT, Defendants.	FEDERAL SECURITIES Civil Action No.Civ. S-77-101 PCW FIRST AMENDED COMPLAINT FOR INJUNCTION

The Plaintiff, Securities and Exchange Commission ("Commission"), for its complaint, alleges:

1. It appears that Defendants Mount Vernon Memorial Park ("Mount Vernon") and

Foy E. Bryant ("Bryant") and each of them, singly and in concert, and aiding and abetting each other, directly and indirectly, have engaged, are engaged and, unless enjoined, will engage in acts and practices which constitute and will constitute violations of, and the aiding and abetting of violations of [...]Section 7(a) of the Investment Company Act of 1940, as amended, ("1940 Act") [15 U.S.C. §80a-7(a)].

2. ... .

3. The Commission brings this action pursuant to ... Section 42(e) of the 1940 Act [15 U.S.C. §80a-41(e)] to restrain and enjoin the Defendants, and each of them, from engaging in and from aiding and abetting the acts and practices set forth herein, and for such further equitable relief as may be necessary and appropriate

under the circumstances.

4. This Court has jurisdiction of this action pursuant to [...] Section 44 of the 1940 Act [15 U.S.C. §80a-43].

5. Certain of the acts, practices, courses of conduct and transactions constituting the violations of the law alleged herein have occurred within the jurisdiction of the United States District Court for the Eastern District of California. In addition, Defendant Mount Vernon Memorial Park has its principal place of business and Defendant Foy E. Bryant resides within the jurisdiction of this Court.

6. In connection with the conduct, acts, practices, and courses of conduct set forth in this complaint, the mails and the means and instrumentalities of interstate communication, transportation and commerce were used.

THE DEFENDANTS

7. Defendant Bryant resides at 8201 Greenback Lane, Fair Oaks, California. During the period relevant to this complaint, Defendant Bryant was the president, a director, and sole shareholder of Defendant Mount Vernon. Between 1958 and 1962, Defendant Bryant was associated with a registered broker-dealer located in Sacramento, California.

8. Defendant Mount Vernon is a closely held California corporation with its principal offices located at 8201 Greenback Lane, Fair Oaks, California. In 1965 Defendant Mount Vernon became licensed by the State of California as a funeral director and as a cemetery authority. Defendant Mount Vernon is currently engaged in the business of performing funeral and burial services and operating a cemetery. It has a three-member board

of directors; however, Defendant Bryant has supervised, controlled and directed Defendant Mount Vernon's operations since its incorporation in 1963.

9. In or about December 1965, Defendant Mount Vernon commenced the sale of cemetery plots and funeral services, both at-need, for a deceased person, and in advance of need or "pre-need". The pre-need contract requires Mount Vernon to perform specified funeral services at a fixed price when the beneficiary dies. While some pre-need contracts have been sold on a cash basis, most have been sold on an installment basis whereby the purchaser makes small monthly payments to Defendant Mount Vernon. By receiving the installment payments in advance of providing the services, Defendant Mount Vernon's pre-need program generated a substantial cash flow which it has used in its operations. However, in October

of 1969, California law was amended to require those providing funeral services, such as Defendant Mount Vernon, to deposit into a trust account 100 percent of the cash received on pre-need funeral service contracts. This reduced the cash available to Defendant Mount Vernon to pay its current expenses. In order to avoid the effects of the new statute, Defendant Mount Vernon restructured its operation in an effort to rely upon an exemption therefrom. The exemption provides that the pre-need contract issuer is not required to place into trust those payments received on pre-need funeral service contracts which employ securities as the funding medium if the securities are issued under a permit granted by the appropriate State of California authorities.

COUNT I

(Section 7(a) of the Investment Company Act of 1940 [15 U.S.C.§80a-7(a)])

10. The allegations contained in paragraphs 1 through 9 are realleged and incorporated herein by reference.

11. Commencing on or about September 9, 1970, and continuing to date, Defendants Mount Vernon and Bryant, singly and in concert, have issued, offered for sale, sold and delivered and are currently issuing, selling and delivering face-amount certificates as defined by Section 2(a)(15) of the 1940 Act [15 U.S.C.§80a-2(a)(15)], in the form of "Pre-Need Funeral Service Debentures ("debentures") to California residents. Some debentures have been sold on a cash basis, but the majority have been sold on an installment basis whereby the purchaser enters into an initial subscription agreement and

becomes committed to make small monthly payments to Defendant Mount Vernon.

12. Debentures are sold on an installment basis in the following manner:

(a) Individuals wishing to purchase funeral services in advance of need execute two separate documents: (1) a funeral service contract whereby Mount Vernon agrees to provide specified funeral services at a stated price, and (2) a subscription agreement whereby the individual agrees to purchase a certain number of debentures on an installment basis. Under these agreements, the dollar amounts of debentures to be purchased and the contract price of the funeral services are generally the same.

(b) Pursuant to the subscription agreements, the debenture investors make periodic installment payments of a stated amount. These installment payments are of

at least $7.50 per month over a period of 60-80 months. The subscription agreements are cancellable on 30 days notice at the option of the investor.

(c) Defendant Mount Vernon issues its debentures in denominations of $100. Thus, after the installment payments it has received cumulate to $100, it issues the investor a $100 debenture. The debentures provide for payment of 3 percent to 4.5 percent interest per annum depending upon the issue involved.

(d) Defendant Mount Vernon's debentures are redeemable for cash by the purchaser at maturity, which is 20 years from the date of issue of the debenture. Prior to maturity, however, they are redeemable for funeral services performed by Mount Vernon at face value plus accrued interest. Should the beneficiary die before the debenture

subscription is fully paid, the difference must be paid at the time the funeral services are performed.

13. During the period from on or about September 9, 1970, to January 9, 1975, Defendant Mount Vernon made four separate debenture offerings to California residents, many of whom are elderly, have limited means, and have little or no experience with securities or other investments. Defendant Mount Vernon marketed its funeral service debentures by means of offering circulars and door-to-door solicitations by its salesmen. The first of the four above-mentioned debenture issues pays 4.5 percent interest; the succeeding three issues each pay 3 percent. Defendant Mount Vernon has induced a large number of debenture purchasers to authorize Defendant Mount Vernon to retain the interest due on

their debentures to be credited to the next installment payment owed by the investor.

14. Defendant Mount Vernon's records are not complete, current, and accurate; however, its records do disclose that as of November 30, 1976, over 4,900 investors:

a) subscribed to purchase in excess of $2.86 million in debentures;

b) paid approximately $2.28 million on these subscription agreements and these debentures are issued and outstanding;

c) paid $80,000 in installment payments upon debentures not yet issued (because the $100

level had not yet been reached by each investor's installments); and

d) owed Defendant Mount Vernon $500,000 in as yet unpaid installments on their subscription agreements.

15. Defendant Mount Vernon has been and is currently using the mails to send bills, receive installment payments, and deliver debentures being issued pursuant to subscription agreements already in effect.

16. As a result of these offers, sales, and deliveries of face-amount certificates of the installment type, and the issuing thereof, Defendant Mount Vernon is an investment company as defined by Section 3(a)(2) of the 1940 Act (15 U.S.C. §80a-3(a)(2) and as such is subject to Section 7(a) of the 1940 Act (15 U.S.C. §80a-7(a)]

which requires registration of investment companies with the Commission pursuant to Section 8 of the 1940 Act [15 U.S.C. §80a-8] prior to engaging in certain transactions, including, but not limited to the offer, sale, and delivery after sale of securities and any business in interstate commerce.

17. No notification of registration pursuant to Section 8 of the 1940 Act [15 U.S.C. §80a-8] has been filed by Defendant Mount Vernon.

18. By reason of the foregoing, Defendants Mount Vernon, and Bryant, directly and indirectly, singly and in concert, and aiding and abetting each other, have violated and, unless enjoined, will continue to violate Section 7(a) of the 1940 Act [15. U.S.C. §80a-7(a)].

...

WHEREFORE, the Commission respectfully prays and demands that the Court:

I

Declare, determine, and find that each of these Defendants has committed the violations herein charged and alleged to have committed by such Defendants.

...

III

Issue preliminary and permanent injunctions restraining and enjoining Defendants Mount Vernon and Bryant, their officers, agents, servants, employees, attorneys, assigns, successors, and all persons acting in concert or participation with them who receive actual notice by personal service or otherwise, and each of them, directly and indirectly, while not registered as an investment company pursuant to Section 7 of the 1940 Act [15 U.S.C.

§80a-7] from making use of the mails and instrumentalities of interstate commerce to offer to sell, sell, and deliver after sale any security; provided, however, that nothing in the foregoing portion of the requested injunction shall apply to any security or transaction which is exempt from the provisions of Section 7(a) [15 U.S.C. §80a-7(a) of the 1940 Act.

IV

Grant such other and further relief, including ancillary relief in the form of a Trustee pursuant to Section 42 of the 1940 Act [15 U.S.C. §80a-41], as the Court may deem just and proper for the protection of investors.

Respectfully submitted,

. . .

Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION
San Francisco Branch Office

DATED: March 11, 1977
San Francisco, California

Opposition

Supreme Court, U.S.
FILED
APR 9 1982
ALEXANDER L. STEVAS
CLERK

No. 81-1639

In the Supreme Court of the United States

OCTOBER TERM, 1981

MOUNT VERNON MEMORIAL PARK AND FOY E. BRYANT,
PETITIONERS
v.
SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

EDWARD GREENE
General Counsel

JACOB H. STILLMAN
Associate General Counsel

DAVID A. SIRIGNANO
Special Counsel

ELLIOT PINTA
Attorney

Securities and Exchange Commission
Washington, D.C. 20549

QUESTION PRESENTED

Whether, under the circumstances of this case, the court of appeals correctly concluded that the petitioner company engaged in the business of issuing face-amount certificates of the installment type, and thus was subject to the registration requirements of the Investment Company Act of 1940.

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINION BELOW

The opinion of the court of appeals (Pet. App. B-1 to B-38) is reported at 664 F. 2d 1358. The judgment, findings of fact and conclusions of law of the district court (Pet. App. D-1 to D-55) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on January 4, 1982. A petition for rehearing was denied on February 8, 1982. The petition for a writ of certiorari was filed on March 5, 1982. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

The pertinent statutory provisions are set forth at Pet. App. A-1 to A-16, except for Section 47(b) of the Investment Company Act of 1940, 15 U.S.C. (Supp. IV) 80a-46(b), which appears in the Appendix to this brief.

STATEMENT

The Securities and Exchange Commission instituted this action against petitioner Mount Vernon Memorial Park ("Mount Vernon") and its president, petitioner Foy E. Bryant, by filing a complaint for injunctive relief in the United States District Court for the Eastern District of California, alleging, *inter alia*, that petitioners violated the Investment Company Act of 1940 by reason of Mount Vernon's failure to register with the Commission as an investment company under that Act.[1] In reversing the decision of the district court, which had dismissed the Commission's Investment Company Act claim, the court of appeals held that petitioners' sale of over $2.5 million in long-term debt securities on an installment basis to more than 4,900 persons during a five year period rendered Mount Vernon a "face-amount certificate company," a special type of investment company required to register with the Commission under the Act (Pet. App. B-3, B-8 to B-10).

1. Since the mid-1960's Mount Vernon, a California corporation operating a mortuary and cemetery business, sold cemetery plots and funeral services on an anticipatory or "pre-need" basis whereby a customer would contract for purchase of a plot and a funeral service and obligate himself to make monthly payments spread over several years (Pet. App. B-4). Beginning in September 1970, Mount Vernon altered its program. In connection with its sale of pre-need

---

[1]Section 7 of the Investment Company Act, 15 U.S.C. 80a-7, prohibits, *inter alia*, any investment company not registered with the Commission from offering for sale or selling any security.

The Commission's complaint also alleged violations of antifraud provisions of the Securities Act of 1933 and Securities Exchange Act of 1934. The district court denied the Commission's motion for a preliminary injunction with respect to the fraud count and the Commission appealed. That count was subsequently settled and was not before the court of appeals (Pet. App. B-12 to B-13).

funeral services it began offering on an installment basis "pre-need funeral debentures"—long-term interest-bearing debt securities (*id.* at B-6 to B-7).[2]

Under the restructured program, a purchaser executed two documents: a funeral service contract and a debenture subscription agreement (Pet. App. B-6). The contract obligated Mount Vernon to provide future services at a fixed price so long as the purchaser kept up his monthly payments (*id.* at B-6 to B-7). Under the subscription agreement, the purchaser agreed to buy over a period of 60-80 months sufficient pre-need debentures—in face amounts of $100 each—to cover the price of the funeral services (*id.* at B-7). Monthly payments, which could be as low $7.50, were accumulated by Mount Vernon until they reached $100, at which time a debenture was issued (*ibid.*). The debentures matured in 20 years and were redeemable at maturity for cash or could be applied at the time of death as payment for funeral and burial services (*id.* at B-7 to B-8).

The debentures were registered with the California Department of Corporations under the state's blue sky law (Pet. App. B-6). Between September 1970 and January 1975, four offerings were made, each totalling one million dollars (*id.* at B-8). When Mount Vernon discontinued its debenture offerings in 1975, approximately 4,900 subscriptions had been sold (*id.* at B-9). As of November 30, 1976,

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[2]The California Attorney General previously had issued an opinion interpreting California's Short Act (Cal. Bus. & Prof. Code §7735 *et seq.* (West 1975)) to require all consideration paid pursuant to installment sale funeral contracts to be held in trust until the services actually were performed, as well as to require Mount Vernon to refund to each purchaser on demand up to 90% of each purchaser's consideration. The court of appeals concluded that Mount Vernon altered its pre-need sales contract in an effort to avoid the trust and refund requirements of the Short Act by taking advantage of an exemption from the Act's requirements for sellers of pre-need funeral contracts who, as part of the program, issued securities (Pet. App. B-5 to B-6).

the aggregate amount of such debentures subscribed to was approximately $2.85 million, of which $2.27 million remained outstanding (Pet. App. D-15 to D-16). Mount Vernon retained 15% of the installment payments in a sinking fund; the remaining 85% was available to meet the company's operating expenses (Pet. App. B-9).[3]

2. The district court concluded that petitioners had not operated an investment company subject to the registration requirements of the Investment Company Act, and dismissed count one of the Commission's complaint seeking injunctive relief (Pet. App. D-49, D-54). The court of appeals reversed (Pet. App. B-37). The court of appeals began its analysis with an examination of the language of Section 3(a) of the Investment Company Act, 15 U.S.C. 80a-3(a), which prescribes three distinct definitions of "investment company" (Pet. App. B-16). Section 3(a)(2) defines that term to include a company which "is engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or has been engaged in such business and has any such certificates outstanding[.]" In turn, Section 2(a)(15) of the Act, 15 U.S.C. 80a-2(a)(15), defines a "face-amount certificate" as

> any certificate, investment contract, or other security which represents an obligation on the part of its issuer to pay a stated * * * sum or sums at a fixed * * * date or dates more than twenty-four months after the date of issuance, in consideration of the payment of periodic installments of a stated or determinable amount (which security shall be known as a face-amount certificate of the "installment type") * * *.

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[3]In February 1976, after the Commission advised Mount Vernon that it was required to register as an investment company, Mount Vernon began to deposit the remaining 85% of the proceeds from the installment payments in a separate bank account (*id.* at B-10).

The court found that this unequivocal language provides a "compelling case for classification of Mount Vernon as an investment company" (Pet. App. B-22).[4] Rejecting the district court's conclusion that the statute must be read to apply only to companies that invest the proceeds from the sale of certificates in securities of other companies, the court of appeals noted (*ibid.*):

> Subsection (a)(2) does not purport to limit the Act's coverage based on the intended use of the money generated from the certificate sales. Quite the contrary, the language is absolute, defining an investment company as any enterprise with face-amount certificates of the installment type outstanding.

The court of appeals addressed petitioners' argument that Mount Vernon could not be an investment company under Section 3(a)(2) since it is in the funeral company business, and not "in the business of issuing face-amount certificates of the installment type" (Pet. App. B-22). The court explained (*id.* at B-22 to B-23) that petitioners'

> argument would be more plausible if the adverb "primarily" appeared in the statute. Without it, it is equally reasonable to say that any issuer is in the business of issuing certificates at least to the extent certificates are actually issued.

In this regard, the court found Section 3(a)(2) unique in that it defines investment companies based on the type of security issued, while Sections 3(a)(1) and 3(a)(3) of the Act, the

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[4]The court of appeals noted (Pet. App. B-17 to B-18):

> A threshold requirement for applicability of the above quoted section is that the instrument in question be a "certificate, investment [contract], or other security." The parties do not appear to contest that the funeral service debentures are investment contracts or securities, and we do not find it necessary to examine the point.

other two definitions of "investment company," define that term based on the disposition of the proceeds from sales of securities (Pet. App. B-24).[5] The court pointed out that adoption of petitioners' argument that a Section 3(a)(2) investment company must be primarily engaged in reinvestment would render Section 3(a)(2) superfluous; under petitioners' interpretation, a company subject to regulation under that provision also would fall within the Section 3(a)(1) definition, and possibly within Section 3(a)(3) (Pet. App. B-25).

The court of appeals next examined the legislative history of the Investment Company Act and found that it supported the literal text. The court acknowledged that the "broadest objectives" of the Investment Company Act lay in regulating those companies investing in securities of other corporations (Pet. App. B-31), but the court determined that Congress had a different purpose in mind with respect to the face-amount certificate provisions, which the court referred to as "a small distinctive part of the Act" (*id.* at B-32 n.6). Based on its careful review of the legislative history, the court concluded that "the legislative history does not indicate that Congress intended reinvestment to be an essential requirement for face-amount companies" (*id.* at B-34). It observed that, in enacting the provisions relating

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[5]Section 3(a)(1), 15 U.S.C. 80a-3(a)(1), defines an investment company as any issuer which

> is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities * * *.

Section 3(a)(3), 15 U.S.C. 80a-3(a)(3), defines an investment company as any issuer which

> is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets * * *.

to face-amount certificates, congressional concern focused primarily on "the plight of those purchasing them * * * [and] the nature of the certificates themselves" (*id.* at B-36 n.8). Thus, the court found (*id.* at B-35; footnote omitted)

> the legislative history consistent with what the structure and language of the Act suggest, that Congress intended to regulate face-amount companies because of the type of certificates they issue or have issued—a face-amount certificate of the installment type.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Review by this Court therefore is unwarranted.

1. The Investment Company Act was enacted principally on the basis of a study of the investment company and investment trust industries conducted by the Securities and Exchange Commission pursuant to a directive of Congress in Section 30 of the Public Utility Holding Company Act of 1935, 15 U.S.C. 79z-4. The results of the Commission's study were submitted to Congress in a series of reports, one of which dealt specifically with face-amount certificate companies. *Companies Issuing Face-Amount Installment Certificates*, H.R. Doc. No. 659, 76th Cong., 3d Sess. (1939) ("*Face-Amount Report*"). The report disclosed that in 1939 there were only three significant face-amount certificate companies in existence. Face-amount companies, the first of which was organized in 1894, have remained few in number. As of September 30, 1981, there were only four such companies registered with the Commission.[6]

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[6]SEC *Classification, Assets & Location of Registered Investment Companies Under the Investment Company Act of 1940 as of September 30, 1981* at i (1982).

In view of the small number of face-amount certificate companies, it is not surprising that this proceeding may be the first time in the 42 year history of the Investment Company Act that any court has been required to consider the scope of the face-amount certificate company provisions of the Investment Company Act.[7] This dearth of judicial precedent reflects the limited number of entities to which the holding in this case might apply. In view of the limited precedential importance of the opinion of the court of appeals and the minor role the face-amount certificate company provisions serve in the administration of the Investment Company Act, review by this Court is not warranted. *Rice* v. *Sioux City Cemetery*, 349 U.S. 70, 74 (1955); *Wilkerson* v. *McCarthy*, 336 U.S. 53, 66 (1949) (Frankfurter J., concurring).

2. Whether Mount Vernon is subject to the requirements of the Investment Company Act is a matter of statutory construction. In *Rubin* v. *United States*, 449 U.S. 424

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[7] In *In re International Funeral Services of California, Inc.*, [1975-1976] Fed. Sec. L. Rep. (CCH) para. 80,363, a mortuary, which proposed to sell pre-need funeral service contracts, applied for an exemption from the provisions of the Investment Company Act pursuant to Section 6(c) of that Act. In denying the exemption, the Commission found that the proposed installment sales of pre-need funeral service debentures constituted the issuance of face-amount certificates of the installment type under Section 2(a)(15) of the Investment Company Act and that, as a consequence, the applicant was an investment company under the Act and was required to regist[illegible]. See also *In re Interment Association of California*, Investment Company Act Rel. Nos. 9942 (Sept. 22, 1977) and 9965 (Oct. 20, 1977), 13 S.E.C. Docket 174 and 485; *In re Groman Mortuaries, Inc.*, Investment Company Act Rel. Nos. 9946 (Sept. 26, 1977) and 9974 (Oct. 26, 1977), 13 S.E.C. Docket 245 and 496. A similar question was discussed in an earlier Commission decision in which the Commission expressly recognized that a company engaged in the business of manufacturing aluminum products would nonetheless be an investment company if it issued face-amount installment certificates. *In re United States Foil Co.*, 9 S.E.C. 22, 26 (1941).

(1981), this Court observed that "[w]hen we find the terms of a statute unambiguous, judicial inquiry is complete, except in 'rare and exceptional circumstances.' " *Id.* at 430, quoting *TVA* v. *Hill*, 437 U.S. 153, 187 n.33 (1978). No exceptional circumstances exist in the present case since the court of appeals' "reading of the statute is wholly consistent with the history and the purposes" of the face-amount certificate provisions of the Investment Company Act. 449 U.S. at 430.[8]

As explained by the court of appeals, Mount Vernon's debenture program is subject to the same type of abuses Congress intended to eliminate when it enacted Section 3(a)(2) of the Act.[9] Petitioners, however, would have this

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[8]Petitioners' reliance (Pet. 22) upon *Train* v. *Colorado Public Interest Research Group, Inc.*, 426 U.S. 1 (1976), is misplaced. In *Train*, this Court reversed the court of appeals' construction of the term "pollutants" appearing in the Federal Water Pollution Control Act and held that the lower court erred in relying exclusively on the statutory language, noting that there is no "rule of law" which forbids consideration of legislative materials however clear the words may appear on "superficial examination." *Id.* at 10, quoting *United States* v. *American Trucking Associations*, 310 U.S. 534, 544 (1940) (footnotes omitted). In this proceeding, the court of appeals relied on both the statutory language and the legislative history in interpreting the face-amount certificate company provisions.

[9]The Commission's report on face-amount certificate companies revealed that, in view of the small periodic installment payments feature, the majority of purchasers of this type of security were individuals in the lowest income brackets. *Face Amount Report* at 32. These persons had little investment experience, were most susceptible to the potential abuses of this type of investment vehicle, and were least able to bear any losses that might occur. The companies frequently induced persons to invest in certificates through promotional efforts which stressed "accumulating for a secure old age." *Id.* at 23. Moreover, the risk that the perceived benefit of the investment would not be realized was substantial. Reserves maintained by many such companies "were inadequate to insure * * * the payment of the certificates at maturity at the face amount." *Hearings on H.R. 10065 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 76th Cong., 3d Sess. 61 (1940). A high forfeiture rate on subscription agreements in

Court deny debenture purchasers the protections of the Act on the ground that Mount Vernon does not reinvest its debenture proceeds in securities. But such a requirement has no basis in the governing statutory provisions and bears no relationship to the type of abuses that Congress meant to eliminate. Thus, petitioners urge a construction of Section 3(a)(2) "that not only is cramped but conflicts with the plain meaning of the statute and its purpose as well." *Rubin* v. *United States, supra,* 449 U.S. at 431.

Petitioners argue (Pet. 8) that, even though a requirement that the issuer reinvest proceeds from the sale of its certificates is not explicitly stated in Section 3(a)(2), that requirement must be inferred from the failure of the legislative history to refer to companies that use proceeds in the operation of their business. "The short answer is that Congress did not write the statute that way." *United States* v. *Naftalin,* 441 U.S. 768, 773 (1979).[10] Moreover, the fact that the

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early years often left the investor, as a result of high service charges allocated to early payments, with no return on his initial payments. *Ibid.* There also was concern that an issuing company would become bankrupt during the long interval between issuance and maturity. *Investment Trusts and Investment Companies: Hearings on S. 3580 Before a Subcomm. of the Senate Comm. on Banking and Currency,* 76th Cong., 3d Sess. 302 (1940).

Like the face-amount certificates discussed in the Commission's report, the debentures offered by Mount Vernon are unsecured, low-installment, unmarketable, long-term notes designed to appeal to individuals of modest means, who are unlikely to have the financial resources to afford a substantial or total loss on their investments. In addition, because Mount Vernon's certificates are not redeemable for cash prior to maturity, and refunds payable to investors who revoke their subscription agreements are limited to money paid since the issuance of the last debenture (a maximum of $92.50) (Pet. App. B-8), the investor is in a precarious position. And, similar to those companies studied by the Commission in its report, Mount Vernon has not provided adequate reserves to assure repayment of the debentures (Pet. 13 n.5).

[10]Petitioners challenge the court's conclusion (Pet. 22) that Section 3(a)(2) would be superfluous if read to include a reinvestment criterion

legislative history does not discuss the particular application of the statute at issue is not an adequate ground for ignoring the plain meaning of a statute. "[I]f Congress has made a choice of language which fairly brings a given situation within a statute, it is unimportant that the particular application may not have been contemplated by the legislators." *Barr* v. *United States*, 324 U.S. 83, 90 (1945). See also *SEC* v. *Variable Annuity Life Insurance Co.*, 359 U.S. 65, 91-92 (1959) (Brennan, J., concurring); *Browder* v. *United States*, 312 U.S. 335 (1941).[11]

Petitioners also assert (Pet. 22-23) that the court of appeals erred in finding Mount Vernon's debentures to be face-amount certificates. While admitting that the debentures have features that bring them within the statutory definition, petitioners nonetheless contend that, under this Court's opinion in *United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837 (1975), "economic reality" requires that the plain meaning of the definition not apply. In this connection, petitioners argue that the debentures constitute an indivisible part of a fixed-price funeral services contract

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(see page 6, *supra*). Petitioners contend in this respect that Section 3(a)(2) would still serve to classify those companies subject to the particular provisions of the Act which apply only to face-amount certificate companies. See, *e.g.*, Section 28 of the Act, 15 U.S.C. 80a-28. It is not Section 3, but rather Section 4 of the Act, 15 U.S.C. 80a-4, however, which classifies investment companies for the purpose of determining which provisions of the Act will apply.

[11] "[I]t would be a strange canon of statutory construction that would require Congress to state in committee reports or elsewhere in its deliberations that which is obvious on the face of a statute. In ascertaining the meaning of a statute, a court cannot, in the manner of Sherlock Holmes, pursue the theory of the dog that did not bark." *Harrison* v. *PPG Industries, Inc.*, 446 U.S. 578, 592 (1980) (footnote omitted). This Court repeatedly has rejected arguments that "would permit an omission in the legislative history to nullify the plain meaning of a statute." *Standefer* v. *United States*, 447 U.S. 10, 20 n.12 (1980).

and, therefore, are not securities within Section 2(a)(15). Petitioners' argument is without merit.

There is no doubt that petitioners' debentures constitute securities. This case does not concern petitioners' pre-1970 program of selling funeral services on an installment payment basis without the issuance of debentures. Mount Vernon in 1970 began issuing interest-bearing debentures and selling them by means of offering circulars pursuant to permits issued under California's blue sky law. And it did so to avoid a state trusting requirement by taking advantage of an exception for pre-need funeral services sold in connection with securities. See note 2, *supra*. Petitioners should not be permitted to assert conflicting interpretations of the term "security" in order to avoid regulation under both state and federal law. Furthermore, the debentures in question are redeemable at maturity for cash and thus cannot be viewed as an indivisible part of the funeral services contract. Cf. *SEC* v. *United Benefit Life Insurance Co.*, 387 U.S. 202, 207 (1967). Moreover, purchasers of the debentures assume the same type of risks that Congress sought to alleviate in enacting the face-amount certificate company provisions. In short, it is petitioners' proposed interpretation—not the interpretation of the court of appeals—that clashes with "economic reality."

3. There also is no merit to petitioners' argument (Pet. 19-21) that, even though Mount Vernon's debenture program brought it within the literal coverage of the face-amount certificate company provisions, Mount Vernon should not be required to register under the Act. For the first time, petitioners assert that if Mount Vernon is found to have violated the registration requirements of the Act, Section 47(b) of the Act, 15 U.S.C. (Supp. IV) 80a-46(b), would render Mount Vernon's funeral contracts void. This contention is simply incorrect. Section 47(b) explicitly

grants the federal courts discretion to enforce contracts entered into in violation of the Act's requirements.[12]

Finally, petitioners complain (Pet. 21) that the regulatory restraints of the Investment Company Act, particularly the reserve requirements imposed by Section 28 of the Act, 15 U.S.C. 80a-28, are ill-fitted to a company such as Mount Vernon that utilizes fixed and other operating assets rather than liquid assets in the conduct of its business. Since Mount Vernon has failed to establish adequate reserves to ensure that it will be able to meet its obligations as its debentures become due, it is not surprising that it resists the

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[12]Section 47(b) was amended on October 21, 1980, as part of the Small Business Investment Incentive Act, Pub. L. No. 96-477, Section 104, 94 Stat. 2277. The amendment was motivated by congressional concern that the former language voiding contracts entered into in violation of the Act was unduly restrictive and posed a danger to the viability of small venture capital companies. 126 Cong. Rec. S13467 (daily ed. Sept. 25, 1980) (remarks of Sen. Nelson). Therefore, Congress deleted the term "void" and substituted new language to

> save[] such contracts if a court finds that enforcement (1) would produce a more equitable result than nonenforcement and (2) would not be inconsistent with the purposes of the Act. The same two-part test is applied to save from rescission any portion of such a contract which has been performed. The amended section, to a certain extent, codifies case law under the present section, and its analogs in other securities laws, by requiring a court to examine the equities of the situation and the purposes of the Act in connection with its decision.

H.R. Rep. No. 96-1341, 96th Cong., 2d Sess. 37 (1980). Furthermore, even the language of former Section 47(b) would have voided contracts entered into in violation of the Act's requirements only with respect to the rights of the violator and not with respect to the rights of the innocent purchasers.

specific requirements of Section 28.[13] That, however, does not suggest that the statutory requirements are inappropriate. Morever, as this Court recently has emphasized:

> "Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute. Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process comes to an end."

Rubin v. *United States, supra*, 449 U.S. at 431 n.8, quoting *TVA* v. *Hill, supra*, 437 U.S. at 194.

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[13]It was not necessary for Mount Vernon to issue securities in order to sell pre-need funeral contracts. In fact, prior to 1970 Mount Vernon funded its pre-need contracts through the use of installment plans which did not involve securities. Since, as the court of appeals found (Pet. App. B-5 to B-6), Mount Vernon adopted the debenture program only to avoid the trust and refund requirements of state law, petitioners' complaints that the analogous requirements of the Investment Company Act are unduly onerous is somewhat disingenuous. Moreover, contrary to petitioners' suggestion (Pet. 21), application of the reserve requirements would not prevent Mount Vernon from operating its funeral business; it would merely require that the proceeds from the sale of the debentures be set aside in a specified fashion to ensure Mount Vernon's ability to meet its obligations.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

REX E. LEE
Solicitor General

EDWARD F. GREENE
General Counsel

JACOB H. STILLMAN
Associate General Counsel

DAVID A. SIRIGNANO
Special Counsel

ELLIOT PINTA
Attorney
Securities and Exchange Commission

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Appendix

APPENDIX

Section 47(b) of the Investment Company Act of 1940, 15 U.S.C. (Supp. IV) 80a-46(b), provides:

> (1) A contract that is made, or whose performance involves, a violation of this subchapter, or of any rule, regulation, or order thereunder, is unenforceable by either party (or by a nonparty to the contract who acquired a right under the contract with knowledge of the facts by reason of which the making or performance violated or would violate any provision of this subchapter or of any rule, regulation, or order thereunder) unless a court finds that under the circumstances enforcement would produce a more equitable result than nonenforcement and would not be inconsistent with the purposes of this subchapter.
>
> (2) To the extent that a contract described in paragraph (1) has been performed, a court may not deny rescission at the instance of any party unless such court finds that under the circumstances the denial of rescission would produce a more equitable result than its grant and would not be inconsistent with the purposes of this subchapter.
>
> (3) This subsection shall not apply (A) to the lawful portion of a contract to the extent that it may be severed from the unlawful portion of the contract, or (B) to preclude recovery against any person for unjust enrichment.

Petitioner's Reply Brief

Supreme Court, U.S.
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No. 81-1639

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1981

MOUNT VERNON MEMORIAL PARK and FOY E. BRYANT,
Petitioners,

vs.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITIONERS' REPLY BRIEF

ROBERT PATRICK MURPHY
COUNSEL OF RECORD
O'BRIEN AND HALLISEY
A Professional Corporation
One California Street,
Suite 2535
San Francisco, CA 94111
Telephone: (415) 433-5300
On behalf of the Petitioners named above

BOWNE-PERNAU WALSH • 180 NINTH ST. • S.F., CA 94103 • (415) 864-2300

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PETITIONERS' REPLY BRIEF

INTRODUCTION

Respondent's Brief in Opposition makes three numbered contentions: 1) That the small number of traditional face amount certificate companies actually registered with the S.E.C. makes the field unworthy of attention by this Court; 2) that the statutory language and the types of abuses listed by the S.E.C. in its 1940 Face Amount Certificate Company review conclusively make the face amount provisions of the Act applicable to Mount Vernon; and 3) that the substantive regulation of the Act is not ill fitted to

Mount Vernon and that the recently enacted replacement to Section 47(b) of the Act is retroactively applicable. We believe it appropriate to call attention to facts and authorities in reply, which show these contentions are not supported. We refer to Respondent's second contention first.

BOTH OF THE COURTS BELOW FOUND THAT THE LANGUAGE OF THE ACT IS NOT CONCLUSIVE

In their analyses both the District Court and the Court of Appeals started with the statutory language. The District Court considered that language in the light of the whole statute and in that context found the meaning of Section 3(a)(2) as applicable to Mount Vernon is not clear. (Petitioner's Appendix D-29 to D-30). The Court of Appeals also found that the language and structure of the Act is not conclusive (Pet. App. B-27). The contention of the Brief in Opposition that the language is conclusive is not supported in the record.

This Court has repeatedly held it to be fundamental that a section is not to be read in isolation from the context of the *whole* statute and in construing a single section it will look to the provisions of the *whole* law with due regard to its purpose. *Philbrook v. Glodgett*, 421 U.S. 707, 713-714 (1975); *Richards v. U.S.*, 369 U.S. 1, 11 (1962); *NLRB v. Lion Oil Company*, 352 U.S. 282, 288 (1957).

As this Court has pointed out, the provisions of the Investment Company Act are substantive and go well beyond the disclosure requirements of the Securities Act. *SEC v. United Benefit Life Insurance Company*, 387 U.S. 202, 212 (1967). In that case and the predecessor case of *SEC v. Variable Annuity Life Insurance Company*, 359

U.S. 65 (1959), this Court applied investment regulations to underlying fact situations involving large pools of liquid capital obtained from small investors with the primary purpose of, in turn, obtaining an investment return. This is not such a case.

Manifestly, the opinion of the Court of Appeals did not construe Section 3(a)(2) in the light of the dominating general purpose and the broadest objectives of the whole Act (Pet. App. B-31 to B-32). cf. *SEC v. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943). The result of the Court of Appeals' construction is that Section 3(a)(2) is a separate, special type of statutory regulation applicable whether or not the issuer constitutes a liquid pool of investment capital. However, the whole Act then applies to it. The Brief in Opposition does not acknowledge this contention.

The Court of Appeals acknowledged that in the Investment Company Act Congress focused primary attention on companies investing in securities of other corporations and issuing securities of their own, citing *U.S. v. National Association of Securities Dealers*, 422 U.S. 694, 697-698 (1975). (Pet. App. B-31 to B-32.) But the Court of Appeals did not go on to determine if Mount Vernon is within the express purposes of the *whole* Act, as set forth by the Congress in Section 1. (See Pet. App. A-3 to A-4.)

The Court of Appeals opinion and the Brief in Opposition arrive at their statutory construction in reliance on a potential for abuses in sales of installment certificates for the simple savings of money by the specific types of traditional investment companies which the S.E.C. studied

in the 1930s. The Court of Appeals opinion concedes that all these companies were in the business of operating liquid pools of capital obtained from small investors for the purpose of, in turn, investing in other securities (Pet. App. B-33 to B-34.) By referring back to the statutory language which the courts had already found to be inconclusive the Brief in Opposition conjures up a legislative intent to restrict any instruments having characteristics of such certificates, no matter what the primary business their issuer may be. This is close to espousing regulation for the sake of regulation alone.

THE COURT OF APPEALS OPINION DID NOT CONSIDER THE ACT'S STATED PURPOSES AND SUBSTANTIVE REGULATIONS AND DID NOT CONSIDER A MATERIAL PART OF THE LEGISLATIVE HISTORY

The decision adopted by the District Court pointed out that, "the extensive and detailed regulatory framework established by the Investment Company Act specifically prescribed and closely limited the operation of registered Investment Companies in a manner which would be inappropriate and onerous if applied to companies which must use non-liquid assets in their business." We omit its footnote which details many of the specific regulations. (Pet. App. D-43.)[1] The Court of Appeals opinion brushes aside these considerations by commenting in a footnote,

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[1]As applied to traditional investment companies the regulations under the Act have been judicially characterized as Draconian. *Willheim v. Murcheson*, 342 F.2d 33, 37 (C.A.2, 1965), *cert. denied* 382 U.S. 840.

"few regulatory schemes are without such consequences." (Pet. App. B-37.)

In its careful examination of the legislative history the District Court took note of the historical fact that the face amount certificate company provisions were only added to the investment company act after compromise negotiations between the S.E.C. staff and representatives of specific face amount certificate company types of investment companies then in existence. (Pet. App. D-31 to D-42, at D-34 to D-36.) In this respect the limited reference to legislative history by the Court of Appeals opinion is incomplete. Respondent's claim that history supports the S.E.C.'s new interpretation is not sustainable.

THE BRIEF IN OPPOSITION MISSTATES PETITIONERS' CONTENTION UNDER UNITED HOUSING FOUNDATION, INC. v. FORMAN

The District Court expressly determined that Mount Vernon's pre-need funeral service debentures were distinct from the types of securities issued by the specific types of companies which the Congress intended to affect. (Pet. App. D-39 to D-42.) The Court of Appeals' opinion made no determination that those findings were in any way erroneous.

The Brief in Opposition misconstrues Petitioner's argument under *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837 (1975) that, in applying the definition of face amount certificate, form should be disregarded for substance and the emphasis should be economic reality, rather than mechanical application of a term in a definition. The Brief in Opposition incorrectly states that Petitioners are

attempting to assert conflicting interpretations of the term "security". (pg. 12) It does not and cannot make any citation to this record to support that claim. The operative definition is not of the term "security" but of the term of "face amount certificate" (Pet. App. A-3.). The presence of a "security" is not essential to the definition. The only discernible purpose of this part of Respondent's discussion is to improperly prejudice determination of the issues. Petitioners' contention is that Mount Vernon's pre-need arrangements do not involve face amount certificates within the meeting and intent of the Act. (See the discussion by the District Court at Pet. App. D-39 to D-46.)

The District Court expressly found that the Mount Vernon debenture subscriptions were negotiated together with pre-need funeral service contracts which fixed the price of the future funeral services at the rate charged at the time of the formation of the contract and that the purchasers were also receiving the attendant benefit of fixing the price for future funeral services and guarding against inflation in the cost of such services. (Pet. App. C-7 to C-9.)[2] The Court of Appeals did not determine that this factual finding was in any way erroneous. Respon-

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[2]These contracts by Mount Vernon contemplated that the proceeds would be used in Mount Vernon's business pending its performance of the funeral services. This enabled it to extend a reduced price. Since they were in return for a reduced consideration, they are not like the entirely distinct sets of investment promises by the issuer in return for fixed consideration, which this Court found in *SEC v. United Benefit Life Insurance Co.*, 387 U.S. 202, 207 (1967), reversing the lower court determination to the contrary reported at 359 F.2d 619, 623 (C.A.D.C., 1968).

dent does not claim that this case does not concern contracts by a fixed-assets cemetery-mortuary, which are primarily for cemetery and funeral services. Nor can there be any claim that, since Mount Vernon had used all contract proceeds received prior to early 1976 in its business, it will be unable to establish the necessary reserves and comply with numerous other provisions of the Act designed for liquid asset businesses.

THE BRIEF IN OPPOSITION INCORRECTLY APPLIES NEW SECTION 47(b) OF THE ACT

In its section on Reasons For Granting The Writ the Petition had indicated *inter alia* that, if sufficient numbers of the 4,900 purchasers of the contracts elected to void them under former Section 47(b) of the Act, all the purchasers would be deprived of the benefits of their agreements. Respondent's complaint that this argument is made for the first time (p. 12) misconceives that it is made as part of Petitioner's reasons for granting the writ because it is one of the factors which show that this decision does not merely affect the interests of Petitioners.

Respondent's assertion that purchasers' vested rights to void their agreements under old section 47(b) are now extinguished by the replaced section is made without any citation to authority (pg. 12-13). *Nichols v. Coolidge*, 274 U.S. 531, 543 (1926) is to the contrary. Moreover, it is clear that retrospective operation will not be given to a statute which interferes with antecedent rights unless such be the unequivocal and inflexible import of its terms and the manifest intention of the legislature. *Greene v.*

U.S., 376 U.S. 149, 160 (1964); *Hassett v. Welch*, 303 U.S. 303, 314 (1938) and cases cited therein.

The Court of Appeals finding that Mount Vernon is an investment company, made without the benefit of a trial record, may be used against Mount Vernon in litigation by others. *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 332-337 (1979). As noted in the Petition (pg. 20), this will jeopardize performance of contracts with thousands of other purchasers. The District Court had expressly pointed out that the effect of holding Mount Vernon to be an investment company under Section 3(a)(2) of the Act could effectively force Mount Vernon out of business (Pet. App. C-5 to C-6.)

A WRIT OF CERTIORARI SHOULD BE GRANTED

The Brief in Opposition concedes that, following the statutory imposition of the regulations which the District Court found to be onerous as applied to non-liquid asset businesses, only a very few companies have been able to remain in business to the extent that they could register with the S.E.C. as face amount certificate type investment companies (pg. 7.) The recent expansion of these restrictions to all other types of businesses is an important development in Federal law.[a] It should be reviewed by this Court.

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Respectfully submitted,

ROBERT PATRICK MURPHY
O'BRIEN AND HALLISEY
A Professional Corporation
Counsel for Petitioners

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[a]By use of these statutory provisions the S.E.C. has already asserted jurisdiction over a large number of California cemetery-mortuaries. It accomplished this by using the procedural device of an administrative opinion on an application for discretionary exemption from some of the provisions of the Investment Company Act by International Funeral Service of California, Inc. Contrary to footnote 7 of the Brief in Opposition, it was not a litigated issue in that case whether International was an investment company. That determination was assumed by the application. (Pet. App. A-48.)

Footnote 7 of the Brief in Opposition also fails to disclose to this Court that each of the remaining cemetery-mortuary cases cited therein involved a settlement in which the applicant expressly did not admit it was an investment company. Moreover, the opinion *In re United States Foil Company* discloses that the applicant in that case was a holding company for the securities of other companies, rather than a company engaged in a manufacturing business, as incorrectly reported in footnote 7 of the Brief in Opposition. *In re United States Foil Company*, 9 SEC 22, 23-24 (1941).